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IN THE

Supreme Court of the United States

OCTOBER TERM, 1967

No. 348

BENEFICIAL FINANCE COMPANY, INC.,
Petitioner,

v.

LEO VINE,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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IN THE

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No. .....

BENEFICIAL FINANCE COMPANY, INC.,
Petitioner,

v.

LEO VINE,
Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

Petitioner, Beneficial Finance Co., prays that a writ of certiorari issue to review a judgment of the United States Court of Appeals for the Second Circuit, which reversed a judgment of the United States District Court for the Southern District of New York dismissing the amended complaint herein.

Opinions Below

The opinion of the United States Court of Appeals for the Second Circuit, appended hereto as Appendix A, is reported in 374 F. 2d 627.

Prior opinions of the United States District Court for the Southern District of New York in earlier stages of this litigation are reported in 252 F. Supp. 212 and [1964-1966 Transfer Binder] CCH Fed. Sec. L. Rep. ¶91,663 and appear in the record (R. 24a, 26a).

Jurisdiction

The judgment of the Court of Appeals was entered on March 13, 1967. A timely petition for rehearing filed on March 28, 1967 was denied on April 11, 1967 (R. 26b, 41b). The jurisdiction of this Court is invoked under 28 U. S. C. § 1254(1).

Questions Presented

1) Whether an involuntary conversion of the respondent's stock into a claim for cash (resulting from a short form merger without any action by respondent) is a sale under Section 10(b) and Rule 10b-5 and within the definition of sale in Section 3(a)(14) of the Securities Exchange Act of 1934, notwithstanding that the definition specifies contractual volition.

2) Whether the deception element of Section 10(b) and Rule 10b-5 necessary to support the complaint of respondent may be found in alleged deceptive securities transactions by the petitioner with persons other than respondent, petitioner having had no securities transaction with the respondent.

Statute Involved

Section 10(b) relating to deception in connection with the sale or purchase of securities, together with the definition of a sale of securities contained in Section 3(a)(14), of the Securities Exchange Act of 1934, 15 U. S. C. § 78 j (b), § 78 c (a)(14), 48 Stat. 891, is appended hereto as Appendix B. Rule 10b-5 of the Securities and Exchange Commission, 17CFR 240.10b-5, promulgated under Section 10(b) is also included in Appendix B.

Statement

The cause of action alleged in the amended complaint (R. 12a) consists primarily of a claim under Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5. There is also alleged a common law cause of action (not separately stated) sought to be brought in the Federal Court on the basis of diversity of citizenship. The Court of Appeals decision rested on the applicability of Section 10(b) and Rule 10b-5, and the common law cause of action was regarded by that Court merely as a pendent claim.

Rule 10b-5 forbids fraud "in connection with the purchase or sale of any security". Section 3(a)(14) states "the terms 'sale' and 'sell' each include any contract to sell or otherwise dispose of."

The respondent is the holder of 100 shares (out of 624,870 shares) of Class A stock of Crown Finance Company Inc., a Delaware corporation (Crown), which he bought for less than $100 in 1962 (R. 13a, 14a, 29b).

Commencing in 1963 petitioner, Beneficial, purchased over 95% of the Class A common shares and all of the Class B common shares of Crown from stockholders of Crown, other than respondent (R. 28a).

Respondent has never, in fact, sold his stock to petitioner. What occurred was that Crown was merged into a subsidiary of petitioner by means of a so-called "short form" merger, which was effected under the applicable state statutes by a subsidiary of petitioner owning over 95% of the Crown stock. No action by respondent was necessary or was sought in connection with such short form merger. Respondent's stock was thereby simply converted without action by him into a claim for cash in the amount of $329 (or a different sum as might be determined at respondent's election in an appraisal proceeding). (R. 13a, 20-21a)

The District Court held that in these circumstances there was no sale and no fraud on respondent within the purview of Rule 10b-5 (R. 26a).

The Court of Appeals held that the short form merger was a "sale" by respondent. Although respondent did no voluntary act and was in no way deceived, that Court held that respondent's allegation that other stockholders of Crown were deceived into selling their stock to petitioner constituted fraud "in connection with" the non-existent "sale" by respondent to petitioner.

The amended complaint revolves around the fact that petitioner paid substantially more, per share, for the Class B common stock (which carried the right to elect two-thirds of Crown's Board of Directors) than it paid for such shares of Class A stock as it purchased. Respondent charges that these purchases by petitioner from others were fraudulent on the ground that, *if* petitioner had purchased all the *assets* of Crown and *if* Crown had been *dissolved* and *liquidated,* each share of Class A stock would have received more, and each share of Class B common stock would have received less, than the purchase price paid by petitioner for the shares. However, this allegation of fraud on others does not confer Section 10(b) or Rule 10b-5 jurisdiction over respondent's claim. He did not sell and he was in no way deceived.

Reasons for Granting the Writ

The Court of Appeals has decided an important question of Federal law, which has not been but should be settled by this Court, and has thereby erroneously extended Federal jurisdiction under the Securities Exchange Act of 1934 beyond the plain intent and meaning of the statute.

The decision, if allowed to stand, will greatly increase litigation in the Federal Courts relating to questions of alleged general corporate mismanagement or wrongdoing heretofore handled in the state courts.

The decision would also greatly expand the scope of trial and pre-trial procedure through which plaintiffs in such cases would try to prove the deception of a multitude of other security holders which enabled defendants in those cases to obtain sufficient stock to give them the power to affect the plaintiffs' securities. This was the alleged causal connection relied on in the Court of Appeals decision to bring this case within the ambit of Section 10(b) and Rule 10b-5 (A-13).

The decision of the Court of Appeals is believed to be clearly erroneous. It is essential for Federal jurisdiction under Section 10(b) that there shall have been (a) a sale which would necessarily involve a voluntary act by the respondent as indicated by the definition in Section 3(a)(14) and (b) deception of the respondent in connection therewith. The opinions of the District Court applied these principles.

Notwithstanding these principles, the Court of Appeals held that an involuntary conversion (resulting from a short form merger in which respondent took no action) of the respondent's stock into a claim for cash was a "sale", and that respondent may maintain a cause of action although he clearly had no transaction with petitioner and was not deceived, on the theory that alleged deception of others was fraud "in connection with" a "sale" of stock by respondent.

Under the laws of Delaware and New York, the short form merger was effected by petitioner's subsidiary solely by the action of its own Board of Directors, because it owned over 95% of the Crown stock. In connection with

such short form merger, no representation was made to respondent and no action was asked or required of him or taken by him. In these circumstances, there was in fact no transaction by respondent "in connection with" which fraud could have been practiced on him.

The situation is analogous to a redemption of stock by a corporation, which has been held not to be a sale by the stockholder within the ambit of Section 10(b), *Mills* v. *Sarjem Corp.*, 133 F. Supp. 753, 763 (D. N. J. 1955). Thus the "sale" element as well as the "deception" element of applicability of Section 10(b) are missing.

In ruling that there was a sale within Section 10(b) and Rule 10b-5, the Court of Appeals seems to rely on the fact that the definition of "sale" in Section 3(a)(14) of the Act states that "sale" shall "include any contract to sell or otherwise dispose of" (A-11). But we point out that this does not purport to make every disposition, involuntary or voluntary, of a security a "sale",—only *contracts to sell or otherwise dispose of* were brought within the definition of "sale", which points up the need for volition. There admittedly was no such sale contract with, or voluntary act by, respondent in the present case.

We submit that the Court of Appeals also was wrong in holding that the alleged deception of other stockholders of Crown who sold shares to the petitioner was a deception "in connection with" a sale by respondent to petitioner.

Can such fraud in connection with a stock acquisition with others be stretched to bring under Section 10(b) and Rule 10b-5 jurisdiction the claim of a person who sold no stock merely because he claims that the fraudulently purchased stock was later used to his disadvantage? Heretofore the courts have been unwilling to find a causal connection in such a situation for the purpose of Rule 10b-5, *Hoover* v. *Allen*, 241 F. Supp. 213, 229 (S. D. N. Y. 1965).

Suppose Crown had remained a Delaware subsidiary of petitioner and the New York subsidiary of petitioner owning over 95% of the stock had not effected a short form merger with Crown. There could then have been no claim by respondent under Section 10(b). Why should there be a different result because the petitioner's New York subsidiary exercised its statutory right to have a short form merger?

Apart from the District Court decision in *Voege* v. *American Sumatra Tobacco Corp.*, 241 F. Supp. 369 (D. Del. 1965), the reasoning of which opinion the Court of Appeals expressly does not accept, the decision of the Court of Appeals is without precedent. In fact the court in the *Voege* case did not attempt to hold that a suit may be brought under Section 10(b) by a person who is not himself a deceived seller or purchaser. Further, it appears that the Court of Appeals decision is inconsistent with leading cases in its own and other Circuits.*

In *Birnbaum* v. *Newport Steel Corp.*, 193 F. 2d 461 (2d Cir. 1952), *cert. denied*, 343 U. S. 956 (1952), the court ruled (p. 464) that Section 10(b) was not intended to be a general regulatory provision and was to be applied only where the appellant was himself a defrauded purchaser or seller, saying that the Section:

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* The situation here is distinguishable from that in *Dasho* v. *The Susquehanna Corp.*, No. 15839 (7th Cir., June 26, 1967). There, the issue was whether the exchange of stock in a company being merged into another company for the stock of the latter was a "sale" of the stock of the surviving company. The Court of Appeals for the 7th Circuit held that it was and that the surviving company had a cause of action under Section 10(b) against its own directors for fraud in connection with its issuance of securities. The case involved a conventional merger, not as here a short form merger which included no issuance of stock by the surviving corporation and no deception of the plaintiff.

> "* * * was directed solely at that type of misrepresentation or fraudulent practice usually associated with the sale or purchase of securities rather than at fraudulent mismanagement of corporate affairs, and that Rule X-10B-5 extended protection *only to the defrauded purchaser or seller.*" (Emphasis added.)

Professor Loss in his treatise on securities regulation notes that the Court's view in *Birnbaum* "seems basically correct" and that "its version of the 'legislative history' of the rule is accurate." 3 Loss, Securities Regulation 1469 (2d ed. 1961).*

The ruling by the Court of Appeals that a sale covered by Rule 10b-5 may take place without any voluntary action by the stockholder and that the required fraud ingredient may be found in alleged fraud in connection with security transactions by the defendant with others than the complaining stockholder seems to us clearly inconsistent with the basic purpose of Section 10(b) and of Rule 10b-5 as set forth in the *Birnbaum* case. The allegations here of injury to respondent cannot possibly be regarded as being based on the type of misrepresentation or fraudulent practice usually associated with the sale or purchase of securities.

The ruling below appears to us also to be inconsistent with *O'Neill* v. *Maytag*, 339 F. 2d 764 (2d Cir. 1964) which reiterates the purpose of Section 10(b) as enunciated in the

---

* As counsel for the Securities and Exchange Commission, Mr. Loss had previously filed a brief to the effect that a conventional consolidation did not constitute a "sale" of securities under the Securities Exchange Act, even though a vote of stockholders was there required. The brief was quoted with approval by the Ninth Circuit Court of Appeals. *National Supply Co.* v. *Leland Stanford Jr. University*, 134 F. 2d 689, 694 (9th Cir. 1943), *cert. denied*, 320 U. S. 773 (1943). In the present case counsel for the SEC filed a brief amicus curiae taking the side of the respondent, but the Commission did not furnish any expertise as to the construction of the statute and there has been no ruling or interpretative action on the point by the SEC.

Birnbaum case, *supra*, and which further holds that, in order for a Rule 10b-5 cause of action to exist, the suing seller or purchaser must himself have been deceived in connection with a security transaction. The rule is the same in the Third Circuit, *Kremer* v. *Selheimer*, 215 F. Supp. 549, 552 (E. D. Pa. 1963).

If the Court of Appeals decision stands, there must logically be a trial as to whether more than 2,000 stockholders of Crown who sold their stock to petitioner were deceived in connection with their sales. This is because the Court of Appeals decision held that the deceit on which the complaint rests was deceit of Class A stockholders who sold enough stock to petitioner to enable it to put through the short form merger. Thus respondent must prove that deceit was practiced on enough selling stockholders to give petitioner the required 95%. What a Pandora's box would be opened up for the District Court to deal with!

It seems to us that the outcome of this petition is of great importance in that the decision of the Court of Appeals would open up a tremendous additional area of Federal jurisdiction under Section 10(b) and Rule 10b-5 not intended by Congress.

CONCLUSION

For the foregoing reasons, this petition for a writ of certiorari should be granted.

Respectfully submitted,

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July 7, 1967

APPENDIX A

Opinion Below

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

No. 67, Docket 30500

(Decided March 13, 1967)

LEO VINE,

Plaintiff-Appellant,

v.

BENEFICIAL FINANCE COMPANY, INC.,

Defendant-Appellee,

and

CHARLES H. DOWD, STUART A. WIXSON, GEORGE J. SPRINGER, C. H. DONOHUE AND CROWN FINANCE COMPANY, INC.,

Defendants.

No. 67, Docket 30500

UNITED STATES COURT OF APPEALS

SECOND CIRCUIT

Argued Oct. 6, 1966

Decided March 13, 1967

Lawrence M. Powers, New York City (Berman & Powers, Ira W. Berman, New York City, on the brief), for plaintiff-appellant.

Wilkie Bushby, New York City (Dewey, Ballantine, Bushby, Palmer & Wood, Joseph Schreiber, Robert I. Fisher, New York City, on the brief), for appellee.

Philip A. Loomis, Jr., General Counsel, David Ferber, Solicitor, Roy Nerenberg, Attorney, Securities and Exchange Commission, Washington, D. C., as amicus curiae, urging reversal.

Before SMITH, HAYS and FEINBERG, Circuit Judges.

FEINBERG, Circuit Judge.

This is another of the growing number of cases based upon section 10(b) of the Securities Exchange Act of 1934 ("the Act"), and Rule 10b-5 promulgated thereunder by the Securities and Exchange Commission. We deal primarily with the first amended complaint of appellant Leo Vine against the appellee Beneficial Finance Company, Inc., which alleges violations of both the Act and state law. The District Court for the Southern District of New York dismissed the complaint. Its basic holding was narrow; the federal action failed because Vine was not a "seller" of securities. For reasons elaborated below, we hold that Vine is entitled to invoke the Act, and reverse the order of dismissal.

I.

The amended complaint alleges: Vine, a resident of New York, has owned during all relevant times 100 shares of Class A common stock of Crown Finance Company, Inc., a Delaware corporation with its principal office in Delaware, as is Beneficial. Beneficial and Crown both are in the business of operating small loan offices. The stock of the former, with over a billion dollars in assets, is listed on the New York Stock Exchange; Crown, a much smaller company, has limited over-the-counter trading in its stock. Crown has two classes of common stock, A and B, with equal voting rights except that A designates one-third of the directors and B, two-thirds. In liquidation, a B share

equals only one-tenth of an A share, and A has a claim on eighty per cent of sums set aside for payment of cash dividends at any time, while the B stockholders have twenty per cent. There were 624,870 A shares outstanding at the relevant times, and 46,500 B shares outstanding. The officers and directors of Crown were its principal Class B stockholders. Vine's claim is that Beneficial, acting in concert with these officers and directors and using means and instrumentalities of interstate commerce and the mails, defrauded Crown and its Class A stockholders by appropriating for Class B stockholders $900,000 which otherwise would have gone to Class A stockholders, and by merging Crown into Beneficial for at least $800,000 less than the fair market value of Crown.

The complaint describes the mechanics of the fraudulent scheme as follows: While negotiating for the acquisition of Crown in the spring and summer of 1963, Beneficial desired to merge Crown into Beneficial at a cost equal to Crown's book net worth, which in June was about $1,680,000, exclusive of good will. Knowing Beneficial's wishes in the matter, Crown's officers and directors [1] conspired with Beneficial to divert to themselves more than a fair share of the price to be paid for Crown. Although these individuals were minority stockholders, they controlled the board of directors. If Beneficial had acted as it should have (according to Vine) and offered in a merger to give all Crown stockholders cash for their stock, or to buy Crown's assets for cash, A stockholders would have voted share for share alike with B stockholders. A's voting superiority would have prevented a merger or sale of assets giving grossly disproportionate proceeds to the B class, since either plan would require two-thirds approval of all stockholders. Even if the total price had remained

[1] Named as defendants, but only Beneficial was served.

the same, the Class A stockholders would then have received about $1,670,000, and Class B, only $12,500, the book value of the stock at the time. But using their fiduciary positions, the Class B stockholders "shape[d] the transaction in such a way" that they were paid about $700,000 for their shares, plus some $200,000 in benefits under employment and consulting agreements. Class A stockholders were paid only $800,000 for their stock, $870,000 less than they should have received. Moreover, but for the fraudulent scheme, Beneficial would have had to pay more than mere book net worth. Beneficial's motive in the conspiracy was to keep the cost of the acquisition down by overpaying the B's and underpaying the A's; Beneficial received at least $300,000 in tangible assets and $500,000 worth of going business value without paying for them.

In sum, in the words of the district judge, "the alleged fraudulent scheme involved three steps: (1) a purchase by Beneficial of the Class B stock from the directors of Crown; (2) a public offer or tender by Beneficial to the holders of the Class A stock to acquire 95% of the total outstanding shares of Crown; and (3) a short form merger of Crown into a wholly-owned New York subsidiary of Beneficial which would result in the acquisition of the remaining shares of Class A stock." Thus, the complaint alleges that in early August 1963, Beneficial agreed with the principal B stockholders to buy their 43,000 shares at $15.00 a share, and later that month made a public offer to A stockholders to purchase A shares for $1.25 a share. This was increased to $2.50 in an offer sent out to remaining A holders in January 1965. Some A holders accepted, not knowing the facts. By the fall of 1965, having acquired ninety-five per cent of the A stock, Beneficial was engaged in completing the merger of Crown into it on a basis which paid minority stockholders $3.29 in cash per share; since this was a short form merger, the assent of

the remaining A stockholders, like appellant Vine, was not necessary. The complaint further alleges that this overall scheme and the various acts and omissions pursuant thereto constituted fraud on the Class A stockholders and were violations of the Act and Rule 10b-5, and New York and Delaware law. The amended complaint seeks $1,700,000 in damages for Crown, plus what Crown's assets were worth in addition to what was paid for them, and punitive damages, all to be paid pro rata to A stockholders who did not participate in the claimed wrongdoing.

II

Beneficial moved in the district court to dismiss the amended complaint. Judge Bonsal found the federal claim insufficient on the ground that plaintiff was not a seller under the Act. As for the state law claim in which jurisdiction was based on diversity, the judge held that it could not stand on its own because the amount in controversy vis-a-vis appellant was less than $10,000. Moreover, the defect in jurisdictional amount could not be remedied by totalling the claims of all A stockholders because the class was a "spurious" one, and the derivative action failed because Crown no longer existed. Hence, the motion was granted and dismissal ordered on February 23, 1966. 252 F. Supp. 212 (S. D. N. Y. 1966).

On March 3, the parties stipulated that a motion to reargue by plaintiff "shall be deemed to be timely made" if plaintiff delivered his motion papers and memorandum to appellee's attorneys by March 10 and made the motion returnable on March 22. Thereafter, on March 10, plaintiff noticed a motion for leave to reargue the dismissal of his amended complaint, and combined with it a motion for leave to file a second amended complaint.[2] On April 6,

[2] The substance of this complaint is discussed at p. 636 infra.

Judge Bonsal denied both motions in a memorandum opinion. CCH Fed. Sec. L. Rep. ¶ 91,663. Appellant's notice of appeal from the order was filed a week later.[3]

[1–5] Neither side expresses any doubt as to our jurisdiction and what has been brought up for review, although Beneficial's brief does correctly state that an order denying reargument is not appealable, In the Matter of Brendan Reilly Associates, Inc., 372 F. 2d 235 (2d Cir. Jan. 30, 1967), and assumes that it is the judgment dismissing the first amended complaint that is being appealed from; both sides argue issues raised by the two amended complaints. Nevertheless, it is well settled that we must satisfy ourselves that we have jurisdiction even if a party does not raise the issue (at least where a substantial question of jurisdiction is apparent), e.g., Levin v. Ruby Trading Corp., 333 F. 2d 592, 594 (2d Cir. 1964), and that timeliness is jurisdictional, Guido v. Ball, 367 F. 2d 882 (2d Cir. 1966) *(per curiam)*. Here, the notice of appeal was not filed "30 days from the entry of the judgment" of dismissal of the first amended complaint, see Fed. R. Civ. P. 73(a), and, as indicated above, the denial of reargument is not appealable. However, the Supreme Court has construed words in its own Rule 11(2) similar to the quoted words to mean that time to appeal runs from the denial of a petition for rehearing by the court from whose judgment the appeal is taken, at least when the petition for rehearing was timely. United States v. Healy, 376 U. S. 75, 77-80, 84 S. Ct. 553, 11 L. Ed. 2d 527 (1964). Moreover, Rule 73(a) itself provides that the thirty-day period for appeal starts anew after denial of a timely motion for a new trial, and by analogy a motion for reargument of a motion to dismiss should also again start the running of

[3] The notice was dated April 7, 1966, but was stamped "Filed" on April 13, 1966.

time for appeal. See 7 Moore, Federal Practice ¶ 73.09[4] at 3183-85 (2d ed. 1966); cf. Terrasi v. South Atl. Lines, Inc., 226 F. 2d 823 (2d Cir. 1955), cert. denied, 350 U. S. 988, 76 S. Ct. 475, 100 L. Ed. 855 (1956). Therefore, Vine's notice of appeal was timely if his motion for reargument stopped the thirty days from running from February 23, the date of dismissal of his first amended complaint. Rule 9(m) of the General Rules for the Southern District required a motion for reargument to be made within ten days after the order dismissing the first amended complaint. Vine's motion was not made in that period because the parties had stipulated within the ten-day period that such a motion would be timely if made by March 10 (less than a week after the ten days expired). It is true that the stipulation was not signed by a judge,[4] but Judge Bonsal did receive and keep the motion *sub judice* some two weeks before deciding it on the merits, so that retroactive approval of the stipulation may be implied. As a result, the motion to reargue dismissal of the first amended complaint was not decided until after thirty days had run from the original order of February 23. Under these circumstances, we think that Vine could reasonably withhold his notice of appeal until the motion to reargue was decided. See Wolfsohn v. Hankin, 376 U. S. 203, 84 S. Ct. 699, 11 L. Ed. 2d 636 (1964), reversing 116 U. S. App. D. C. 127, 321 F. 2d 393 (D. C. Cir. 1963); Thompson v. Immigration & Naturalization Serv., 375 U. S. 384, 84 S. Ct. 397, 11 L. Ed. 2d 404 (1964). As to what was brought here for review, considering the manner in which the parties have so far proceeded, we are confident that both the February 23 and

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[4] See Rule 12, General Rules of United States District Courts for the Southern and Eastern Districts of New York, specifying which consent orders shall be signed by a clerk without submission to a judge; cf. Orange Theater Corp. v. Rayherstz Amusement Corp., 130 F. 2d 185 (3d Cir. 1942).

April 6 orders of Judge Bonsal are within our appellate purview. See Foman v. Davis, 371 U. S. 178, 83 S. Ct. 227, 9 L. Ed. 2d 222 (1962).

III.

[6] Turning to the merits, we consider first the amended complaint's federal claim under the Act and Rule; the factual allegations in the complaint must, of course, be taken as true, since judgment was granted on a motion to dismiss. The district court's narrow holding was that since Vine neither accepted the offer to purchase his stock nor surrendered his stock pursuant to the statutory short form merger, he was not a seller, and therefore there could have been no fraud as to him in connection with the purchase or sale of a security.

Section 10 of the Act, 15 U. S. C. § 78j, provides:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—
>
> * * *
>
> (b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

Rule 10b-5 of the Commission, 17 C. F. R. § 240.10b-5 (1964), provides:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,
>
> (a) To employ any device, scheme, or artifice to defraud,
>
> (b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
>
> (c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,
>
> in connection with the purchase or sale of any security.

Although the complaint was properly characterized by the district judge as "diffuse," it does allege a "scheme * * * to defraud" and a "course of business which * * * would operate as a fraud" within subsections (a) and (c) of the Rule.[5] In this court, therefore, the narrow question is once again whether appellant is a seller, both parties assuming that *Birnbaum* v. *Newport Steel Corp.*, 193 F. 2d 461 (2d Cir.), cert. denied, 343 U. S. 956, 72 S. Ct. 1051, 96 L. Ed. 1356 (1952), requires this status for him.[6] Appellee claims that Vine is not a seller; appellant argues that he is indeed a seller, albeit a forced one, as a result of the short form merger.

Appellant's position is controlled by the mechanics of a short form merger. It is unclear whether the merger was

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[5] A violation of subsection (b) is also alleged in general terms.

[6] An alternative suggestion of *amicus* Securities and Exchange Commission argues for a broader reading of the law, discussed below.

carried out under Delaware or New York law, but the respective statutes are similar enough. New York Business Corporation Law, McKinney's Consol. Laws, c. 4, § 905(a) authorizes a corporation owning at least ninety-five per cent of the outstanding shares of each class of another corporation to merge the latter corporation into the former without the authorization of the shareholders of the latter corporation, on approval of the board of the former corporation (see § 907(c) for foreign corporations). Under Delaware Code Ann. tit. 8, § 253(a) (Supp. 1964), the surviving corporation need only own ninety per cent of the subsidiary. The consent of the remaining five per cent (or ten per cent) stockholders is not required to effectuate a short form merger. However, such stockholders are given an opportunity to obtain the fair value of their shares, either by agreement with the corporation (presumably this is the source of the $3.29 figure alleged by appellant) or by a judicial proceeding—the so-called "appraisal." See generally Israels, Corporate Practice 283-98 (1963); Note, Valuation of Dissenters' Stock Under Appraisal Statutes, 79 Harv. L. Rev. 1453 (1966).

[7] Thus, once the conditions for a short form merger had been achieved, appellant's rights in his stock were frozen. He had and still has only the options of exchanging his stock for $3.29 a share, pursuant to appellee's offer, or pursuing his right of appraisal, which would also result in cash from appellee. Other than that, with one possible exception to be discussed below, appellant is left only with certificates of ownership in a non-existent corporation. Since, in order to realize any value for his stock, appellant must exchange the shares for money from appellee, as a practical matter appellant must eventually become a party to a "sale," as that term has always been used. See 1 Corbin, Contracts § 4 (1963). It is true that appellant still has his stock; if he turned it in for the price of $3.29 a share,

it would be clearer that appellant is a seller. Assuming that this would not otherwise affect his right to sue under the Act and the Rule, requiring him to do so as a condition to suit seems a needless formality.

[8] We do not construe the Act so narrowly. As noted above, section 10(b) of the Act applies to the "purchase or sale" of securities. Section 3 of the Act, 15 U. S. C. § 78c, provides:

> (a) When used in this title, unless the context otherwise requires—
>
> • • •
>
> (13) The terms "buy" and "purchase" each include any contract to buy, purchase, or otherwise acquire.
>
> (14) The terms "sale" and "sell" each include any contract to sell or otherwise dispose of.

It has been pointed out that the verb "include," rather than the verb "means," emphasizes the breadth of this definition, see *United States* v. *Robertson,* 181 F. Supp. 158, 162 (S. D. N. Y. 1959) (construing similar language in the Securities Act of 1933), and the phrases "or otherwise acquire" and "or otherwise dispose of" are hardly limiting. We do not have here a stockholder who refuses to accept a fraudulent offer to purchase his stock but remains a stockholder in an existing corporation; whether to label this hypothetical person a "seller" under the Rule is a much different question. Due to defendant's acts, Crown has now disappeared and plaintiff's stock has, in effect, been involuntarily converted into a claim for cash. The only case cited to us on all fours is *Voege* v. *American Sumatra Tobacco Corp.,* 241 F. Supp. 369 (D. Del. 1965), in which the court concluded, although on a different theory from the one adopted here, that a short form merger brought about a

fraud related to a "sale" of plaintiff's stock, even though she still physically possessed it. But see *Dasho* v. *Susquehanna Corp.*, —— F. Supp. ——, N. D. Ill., June 28, 1966 (motion for rehearing), appeal pending, 7th Cir. We find no other case squarely in point, although *Ruckle* v. *Roto American Corp.*, 339 F. 2d 24 (2d Cir. 1964), and *Hooper* v. *Mountain States Sec. Corp.*, 282 F. 2d 195, 202-203 (5th Cir. 1960), cert. denied, 365 U. S. 814, 81 S. Ct. 695, 5 L. Ed. 2d 693 (1961) ("otherwise dispose of"), both indicate receptivity on different facts to a broad construction of "sale" under the Act and Rule.[7] Although other cases are cited to us by appellees, none of them in fact is controlling.[8]

[9] Under the particular circumstances of this case, we hold that appellant is a seller under the Act. Moreover the converse is, therefore, true; Beneficial, if the allegations of the complaint are accepted, is a purchaser of plaintiff's stock through its agent and wholly-owned subsidiary Beneficial Finance Company of New York, Inc. The *amicus* brief points out that the fraud alleged here is properly regarded as in connection with the purchase of the Class A stock, rather than a sale, since the wrong-

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[7] See also Polakoff v. Delaware Steeplechase & Race Ass'n, 254 F. Supp. 574 (D. Del. 1966); Simon v. New Haven Board & Carton Co., 250 F. Supp. 297 (D. Conn. 1966); Eagle v. Horvath, 241 F. Supp. 341 (S. D. N. Y. 1965); H L. Green Co. v. Childree, 185 F. Supp. 95 (S. D. N. Y. 1960); Blau v. Hodgkinson, 100 F. Supp. 361 (S. D. N. Y. 1951); Fleischer, "Federal Corporation Law": An Assessment, 78 Harv. L. Rev. 1146, 1153 n. 37 (1965); 3 Loss, Securities Regulation 1469-71 (2d ed. 1961).

[8] E. g., there was no deception in O'Neill v. Maytag, 339 F. 2d 764 (2d Cir. 1964); in Birnbaum v. Newport Steel Corp., 193 F. 2d 461 (2d Cir.), cert. denied, 343 U. S. 956, 72 S. Ct. 1051, 96 L. Ed. 1356 (1952), plaintiffs had not sold their stock and were not being forced to; Barnett v. Anaconda Co., 238 F. Supp. 766 (S. D. N. Y. 1965), involved lack of causality between the deception and the injury.

doing emanates from the purchaser. We accept this characterization and note that it does not change the substance of the legal right involved.

[10–12] Appellee vigorously contends that appellant cannot be a defrauded seller because nothing was asked of him, no representations were made to him—indeed, under the merger statute, nothing had to be communicated to him but notice of his right to the offered $3.29 or to demand an appraisal. But it is precisely because appellee gives no choice to Vine under the statute and the latter must now exchange his shares for cash that appellant can now be deemed a seller. But appellee says, assuming that conclusion of the merger makes appellant a seller, any deception was in connection with the earlier stock acquisition from the ninety or ninety-five per cent of A stockholders, and that deception did not relate to appellant, who did not sell at that time. This ignores the simple fact that appellant would never be in the position of a forced seller were it not for the fraud. In essence, because of the distinctive nature of the short form merger procedure, appellee by deceiving A can cause B to become a seller. When this is all part of a single fraudulent scheme and that scheme is a classic example of deception of an entire class of Class A public stockholders, as alleged here, we think the policies of section 10(b) and Rule 10b-5 justify holding that fraud on A is "in connection with" the forced sale by B. Appellee's point really is that reliance is a requirement in a Rule 10b-5 action and that appellant could not have relied on any deception because no representation was made to him. The need for such reliance by a plaintiff has been the subject of much recent scholarly analysis. See, e.g., Painter, Insider Information: Growing Pains for the Development of Federal Corporation Law Under Rule 10b-5, 65 Colum. L. Rev. 1361, 1366–1372 (1965); Note, Civil Liability Under Section 10b and Rule 10b-5: A Suggestion for Replacing the Doctrine of Privity, 74

Yale L. J. 658, 667–674 (1965). Whatever need there may be to show reliance in other situations, see List v. Fashion Park, Inc., 340 F. 2d 457, 462-464 (2d Cir.), cert. denied, 382 U. S. 811, 86 S. Ct. 23, 15 L. Ed. 2d 60 (1965); Rogen v. Ilikon Corp., 361 F. 2d 260, 266-268 (1st Cir. 1966), we regard it as unnecessary in the limited instance when no volitional act is required and the result of a forced sale is exactly that intended by the wrongdoer. Since the complaint alleges that plaintiff, in effect, has been forced to divest himself of his stock and this is what defendants conspired to do, reliance by plaintiff on the claimed deception need not be shown. What must be shown is that there was deception which misled Class A stockholders and that this was in fact the cause of plaintiff's claimed injury. The allegations of this complaint meet that test.

[13, 14] The district court pointed out that the New York statutory scheme for short form mergers preserves appellant's right to challenge the legality of the merger.[9] N. Y. Business Corporation Law § 623(k). Appellee claims this to be a misreading of the law; however, we need not tarry over this for we do not regard the existence of a state remedy as negating the federal right. See J. I. Case Co. v. Borak, 377 U. S. 426, 433-435, 84 S. Ct. 1555, 12 L. Ed. 2d 423 (1964). Appellee also points out that the *amicus* Securities and Exchange Commission has previously advocated that mergers do not result in sales of stock by dissenters.[10] We note that whatever stance it adopted

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[9] This is the possible exception to the description of appellant's rights referred to at p. 634 supra; appellee does not agree with the district court in this respect, arguing that "a short form merger in its nature cannot be attacked by a minority stockholder as fraudulent."

[10] Reference is made to an *amicus* brief of the Commission in National Supply Co. v. Leland Stanford Junior University, 134 F. 2d 689 (9th Cir.), cert. denied, 320 U. S. 773, 64 S. Ct. 77, 88 L. Ed. 462 (1943), which construed the Securities Act of 1933.

two decades ago, the Commission strongly urges in this case that the short form merger resulted in a purchase and sale of plaintiff's stock within the meaning of Rule 10b-5.[11] Indeed, the Commission advances the alternative argument that plaintiff need not even be a selling stockholder to sue under 10b-5, so long as the Rule has been violated and plaintiff's stock lost value as a result. The Commission claims in effect that prior decisions in this circuit,[12] often cited for the rule that only a seller or purchaser may bring a Rule 10b-5 action, have been too broadly read and can be distinguished, see Leech, Transactions in Corporate Control, 104 U. Pa. L. Rev. 725, 832-835 (1956). In view of our disposition of this case, it is unnecessary to deal with this interesting contention. Finally, appellee argues that appellant can show no injury because the complaint alleges that the interest of the 624,870 outstanding shares of Class A stock amounted to $1,670,000 or $2.67 a share, while non-selling A stockholders were offered a minimum of $3.29 a share. However, the damages alleged to A stockholders do not rest solely on the $1,670,000 figure, but also include the sum of $800,000; this amounts not to less than $3.29 per A share, but to more.[13]

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[11] Moreover, in SEC v. National Sec., Inc., 252 F. Supp. 623 (D. Ariz. 1966), the Commission attacked a consolidation and reorganization under Rule 10b-5.

[12] Birnbaum v. Newport Steel Corp., 193 F. 2d 461 (2d Cir.), cert. denied, 343 U. S. 956, 72 S. Ct. 1051, 96 L. Ed. 1356 (1952); O'Neill v. Maytag, 339 F. 2d 764 (2d Cir. 1964); List v. Fashion Park, Inc., 340 F. 2d 457 (2d Cir.), cert. denied, 382 U. S. 811, 86 S. Ct. 23, 15 L. Ed. 2d 60 (1965).

[13] It should also be pointed out that if appellant states a federal claim—as we hold he does—he also purports to represent those selling A stockholders who accepted the $1.25 per share public offer of August 1963, or the $2.50 public offer of January 1965, all of whom may have been injured, if the allegations of the complaint are true.

IV.

As indicated above, plaintiff also appeals from denial of his motion for leave to file a second amended complaint. That complaint extends the beginning of the fraudulent scheme back to 1950; it claims that when plaintiff bought his A stock, he was a defrauded buyer, because he and others were misled into buying a de facto subsidiary of Beneficial instead of an independent company, and that the new information in support of this claim was not discovered until just before the second amended complaint was filed. Thus, the second amended complaint presents another Rule 10b-5 theory: that plaintiff was a defrauded purchaser when he acquired his one hundred shares of Crown stock in 1962,[14] as well as a defrauded seller in 1963-1965, when the scheme to execute a short form merger was consummated. Judge Bonsal apparently denied leave to file this complaint on alternative grounds: (1) The new information alleged in the complaint was within plaintiff's knowledge before argument of the motion to dismiss the first amended complaint; (2) the amendment is insufficient as a matter of law, since Beneficial's consideration of future acquisition of Crown at the time of plaintiff's purchase of stock was not a material fact which had to be disclosed to plaintiff, and no damage was caused plaintiff by the failure to disclose that intention.

[15] Thus, one basis for denial of leave to amend was the bad faith of appellant in waiting to see how he would fare on the prior motion to dismiss. Although "leave shall be freely given when justice so requires," Fed. R. Civ. P. 15(a), in these circumstances it was certainly within the district court's discretion to deny leave to amend because of "undue delay, bad faith or dilatory motive." See Foman v. Davis, 371 U. S. 178, 182, 83 S. Ct. 227, 230, 9 L. Ed. 2d

[14] The briefs assume that this is the date, although the proposed second amended complaint does not so allege.

222 (1962). Moreover, from all that appears from the allegations, the only damage suffered by plaintiff as a purchaser was the abstract deprivation of knowledge that Crown was a "de facto" subsidiary of appellee. This status may have increased the value of Crown stock; the second amended complaint does not allege how this concealment harmed him financially, apart from laying the groundwork for the alleged fraud in merging Crown with Beneficial. The latter, of course, merely restates the claim casting plaintiff as a forced seller for too little consideration. So long as that claim stands, alleging fraud on plaintiff as a purchaser in this case is not a distinctive ground for relief. Accordingly, Judge Bonsal's decision is in this respect affirmed.

[16] Having determined that appellant has an individual federal claim under section 10(b) of the Act and the Rule, we turn to the problems posed by the jumbling together in the complaint of the derivative and class claims. Taking the former first, the district court held that plaintiff could not maintain an action on behalf of the now nonexistent corporation (Crown) under the Delaware law the court regarded as applicable. Appellant's attack on that conclusion raises a variety of formidable questions, such as whether New York or Delaware law controls in determining whether a foreign corporation (Crown) survives for purposes of suing to redress state-created rights, and what the law in the respective jurisdictions actually is.[15] Fortunately, these problems need not be pursued for we see no reason why Crown and, therefore, its shareholders

[15] Whether the ultimate question is simply one of capacity to sue, see Fed. R. Civ. P. 17(b); cf. N. Y. Business Corporation Law § 1306, or of capacity plus what particular substantive rights run to a merged corporation, see N. Y. Business Corporation Law § 906(b) (3); Beloff v. Consolidated Edison Co., 300 N. Y. 11, 87 N. E. 2d 561 (1949); Braasch v. Goldschmidt, 199 A. 2d 760 (Del. Ch. 1964), is itself one of no little difficulty.

derivatively may sue, even assuming capacity of the defunct corporation. Appellant obviously does not wish to recover benefits which will accrue to holders of Crown's Class B stock, "virtually all" of whom he characterizes as part of a conspiracy to defraud. As for A holders, they can be protected through the class action. The corporation itself is no longer functioning for any purpose, so it is senseless to talk of benefits that will be derived from Crown by this litigation. Appellant suggests that if the whole controversy revolves around Crown as a nominal indispensable party (so that the corporation will receive papers in the litigation), Beneficial New York would do nicely in its place. The plausibility of this suggestion only serves to point up the meaninglessness of a derivative suit on behalf of Crown—a corporation which has been swallowed whole by the subsidiary of the defendant-wrongdoer. Compare Perlman v. Feldman, 219 F. 2d 173, 50 A. L. R. 2d 1134 (2d Cir.), cert. denied, 349 U. S. 952, 75 S. Ct. 880, 99 L. Ed. 1277 (1955), where recovery went to shareholders, instead of the corporation in whose right the action was brought.

[17] Turning to the action allegedly on behalf of all Class A stockholders, the district court considered only its effect upon jurisdiction, since dismissal of the federal claim required diversity and jurisdictional amount for the state law claim. In view of our reinstatement of the federal claim, this aspect of any class action becomes unimportant since jurisdiction is pendent to the federal claim. Other questions affecting the class action should be passed upon in the first instance by the district court judge under Fed. R. Civ. P. 23.

The district court order dated February 23, 1966, dismissing the first amended complaint is reversed except insofar as it dismisses the derivative action; the order dated April 6, 1966, is affirmed insofar as it denies leave to file a second amended complaint. The case is remanded for further proceedings consistent with this opinion.

APPENDIX B

Statute and Rule Involved

SECURITIES EXCHANGE ACT OF 1934:

§ 3(a)(14). Definitions and Application—Definitions

"(a) When used in this chapter, unless the context otherwise requires—

* * *

(14) The terms 'sale' and 'sell' each include any contract to sell or otherwise dispose of."

* * *

(15 U. S. C. § 78c (a)(14) (1964))

§ 10. Manipulative and deceptive devices

"It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—

* * *

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors."

(15 U. S. C. § 78j (1964))

SECURITIES EXCHANGE COMMISSION RULE 10b-5

"Employment of manipulative and deceptive devices.

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

(a) To employ any device, scheme, or artifice to defraud,

(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,

in connection with the purchase or sale of any security."

(17 C. F. R. 240.10b-5)

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1967

No. 348

BENEFICIAL FINANCE COMPANY, INC.,

Petitioner,

v.

LEO VINE,

Respondent.

BRIEF IN OPPOSITION TO A PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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BRIEF IN OPPOSITION TO A PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

The petition for a writ of certiorari to review a judgment of the United States Court of Appeals for the Second Circuit should be denied.

Question Presented

For purposes of the Federal securities laws, is a public stockholder a "seller" of securities when he is forced to surrender his shares in a going business for cash, as a result of a short-form merger?

Statement

Crown Finance Company ("Crown") was a small publicly owned finance company, whose stock was traded in the over-the-counter market when plaintiff

(Respondent) Vine bought 100 shares of its Class A Common Stock in 1962. Unknown to Vine, Crown had been a subsidiary of Beneficial Finance Company, Inc. ("Beneficial") until 1950, and had shared an interlocking directorate with Beneficial for many years. After 1950, the former employees of Beneficial, who constituted Crown's key officers and directors, maintained their close working relationship with their former employers at Beneficial. In 1963, Beneficial and the directors of Crown formulated a plan whereby Beneficial would reacquire Crown from these friendly "insiders" and the public owners of Crown's stock.

This plan is the subject matter of Vine's complaint. Vine alleges that the plan was a scheme to defraud the public stockholders of Crown by reacquiring the corporation at less than its full value and allocating the consideration required so as to grossly overpay the "insiders" for their securities and grossly underpay the public for its securities.

The steps in the plan were (1) a non-arms length buy-out of control stock, made possible through Beneficial's control over Crown's officers and directors, (2) a series of misleading tender offers to the public which achieved a buy-out of 95% of the outstanding stock of Crown, and (3) a short form merger under state law resulting in an involuntary sale to Beneficial's New York subsidiary of the remaining shares in the hands of the public, whose numbers were sufficiently reduced through the effects of steps (1) and (2) to permit this final "freeze out" of the public shareholders. In the short form merger, the surviving corporation, Beneficial, was able to require remaining

minority shareholders in Crown to take cash in exchange for their securities, and retain the assets and business of Crown for itself. Vine contends that this was a "forced sale" of his securities in Crown.

Plaintiff's case is that the whole series of events were motivated and tainted by a scheme to defraud and that the key step (2) involved a series of tender offers which clearly violated the securities laws. At the end of the game, Beneficial had the going business and properties of Crown at an unconscionably low price, and plaintiff had merely the right to a cash sum of $3.29 per share for his stock. All these carefully planned moves by Beneficial were essential steps in the execution of the scheme and not just unrelated events. Each step in the scheme was aimed at buying out or cancelling out securities held by the public. and plaintiff therefore complains that he was a forced seller of his stock in Crown, under a scheme to defraud in connection with such sale.

The details of the scheme are as follows: For some time prior to the merger there were two classes of Crown stock outstanding: 624,870 shares of Class A stock and only 46,500 shares of Class B stock. Over 97% of the shares of Class B stock were in the hands of the officers and directors of Crown; the Class A stock was in the hands of the public. The B stock, as a class, had the right to elect two-thirds of Crown's Board of Directors, but each share of the publicly held Class A stock had the right on liquidation to ten times the sum paid to each share of Class B stock. On all matters, such as mergers and liquidations, each share of the two classes of stock voted share for share alike.

The overt acts in Beneficial's scheme commenced in 1963. First, Beneficial negotiated with Crown's officers to re-acquire Crown, its former subsidiary, in its entirety as a going concern. The task was greatly facilitated since Crown's insiders were former Beneficial employees, the two companies had had interlocking directorates, and among other things, age motivated Crown's officers toward the security which Beneficial offered in a merger.[1] Arm's-length bargaining did not take place. As a result of these negotiations, Beneficial purchased the controlling Class B stock of Crown from its officers and directors, at $15.00 per share, for almost $700,000 in excess of its book value. These insiders were also given some $200,000 in benefits under employment and consulting agreements. Consequently they received some $900,000 at the time the book value of their Class B stock was approximately $12,500 or $.27 per share. Respondent's Appendix pp. 33, 35-37, 39.[2]

Secondly, several tender offers were made by Beneficial to the public holders of the Class A stock. The first tender offer was made in the same month that Beneficial purchased the Class B shares. When in-

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[1] These facts which laid the groundwork for the fraud in merging Crown with Beneficial were discovered after the action was filed. They were before the Circuit Court in the allegations of the proposed Second Amended Complaint, and are summarized in the opinion below by the references to Crown being a defacto subsidiary of Beneficial instead of an independent company. (A.17) These key facts will, of course, be part of ultimate proof in the case under the allegations of non-arms-length bargaining contained in that portion of the Amended Complaint upheld by the Court below.

[2] References herein to Respondent's Appendix are indicated by "Respondent's Appendix —". References to Petitioner's Appendix are indicated by "A. —".

sufficient shares were tendered at $1.25 per share, the offer was raised to $2.50 per share. In making its tenders, Beneficial failed to inform Crown's public stockholders of Beneficial's relationship and prior arrangements made with Crown's insiders, the true book value of the public's shares, the value of their shares on liquidation, the worth of the business, and other material facts. Respondent's Appendix pp. 37-38.

Even the District Court, which first dismissed Vine's complaint conceded that the misleading tender offer gave rise to a securities fraud cause of action in favor of the Crown stockholders who accepted the offer. The amicus curiae brief of the Securities and Exchange Commission characterized the tender offer as "a clear violation of Rule 10b-5." (Respondent's Appendix pp. 45, 36)

By 1965, Beneficial had purchased 95% of all the Crown stock. No vote of shareholders now being necessary under state law, Beneficial completed the third stage, the short form merger of Crown into Beneficial. Beneficial now offered to pay the remaining minority Crown Class A stockholders $3.29 per share, while it succeeded to the properties and business of Crown through the merger into Beneficial's New York subsidiary. Respondent's Appendix pp. 40-41.

As a result of the scheme, Class A stockholders received only $800,000 for their stock, $870,000 less than they would have received if they were paid merely the book value of their shares, $1,670,000. Class B insiders received the disproportionate benefits already described. Beneficial, by gaining the aid of the Class B insiders, and by underpaying the Class A public

stockholders purchased at least $300,000 in tangible assets and $500,000 in going concern value, i.e. a windfall of $800,000 in values without paying for them. Respondent's Appendix p. 39.

Beneficial could not have accomplished this result if Crown's "insiders" had not been willing pawns, and Beneficial had forthrightly offered to purchase all of Crown's stock or had permitted Crown's public stockholders to vote upon the overall plan of merger. Vine refused to surrender his share certificate when the merger went through, and his stock has become a claim for cash, $3.29 per share, i.e. a kind of note owed by Beneficial's New York subsidiary which survived the merger.

The action was brought by Vine both derivatively and on behalf of all the Class A stockholders on the ground that Beneficial had defrauded Crown and its Class A stockholders in violation of Rule 10b-5, 17 C.F.R. 240.10b-5 promulgated under Section 10b of the Securities Exchange Act of 1934 ("the Act" or "the 1934 Act"), 15 U.S.C. 78(j)(b). A common law clause of action was also alleged.

The District Court granted a motion to dismiss the complaint on the ground that Vine was not a "seller" of securities and therefore had no standing to bring an action based on a violation of Rule 10b-5. The Court of Appeals reversed the District Court insofar as it had dismissed the representative action and held the complaint stated a cause of action under Rule 10b-5. The petition is addressed to this aspect of the unanimous decision below.*

* Certain other procedural steps are not relevant here.

As did the District Court, the Court of Appeals concentrated on the technical question of interpreting "seller" and "purchaser" as those terms are defined in the Act. The Court of Appeals had the aid of a brief filed amicus curiae by the Securities and Exchange Commission at the invitation of the Court, agreeing in substance with Vine's position that he was a forced seller of securities in the short-form merger, and Beneficial was a purchaser of those securities in the transaction. (Respondent's Appendix 20-25)

The Petition Should Not Be Granted because the Decision Below Merely Applies Existing Principles as to the Nature of a "Seller" of Securities Under the Securities Acts.

I

The decision below was a narrow holding to the effect that the exchange of stock for cash as a result of a merger is a "sale" of securities, if a scheme to defraud underlies the transaction. The starting point of the decision was the wise principle that the securities statutes are not aimed at corporate mismanagement in general, but only at wrongdoing involving transactions in securities. In recognizing the validity of Vine's position the Second Circuit was mindful that the Securities Exchange Act of 1934 was one of

> "a series of Acts designed to eliminate certain abuses in the securities industry, abuses which were found to have contributed to the stock market crash of 1929 and the depression of the 1930's. . . . A fundamental purpose common to

> these statutes, was to substitute a philosophy of full disclosure for the philosophy of caveat emptor and thus to achieve a high standard of business ethics in the securities industry. As we recently said in a related context, 'It requires but little appreciation . . . of what happened in this country during the 1920's and 1930's to realize how essential it is that the highest ethical standards prevail' in every facet of the securities industry. *Silver* v. *American Stock Exchange*. . . ." *SEC* v. *Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 186-7 (1963).

In the case at bar, the Second Circuit's carefully phrased decision is expressly limited to the technical points covered by the decision of the District Court dismissing the Amended Complaint.

> "Its basic holding was narrow; the federal action failed [in the view of the District Court] because Vine was not a 'seller' of securities." (A. 2)

In reversing the order of dismissal the Court of Appeals' decision was grounded upon the definitions of "seller" and "purchaser" as they appear in the Act. The Second Circuit expressly limited its holding that Vine must be considered a seller by stating that:

> "Under the particular circumstances of this case, we hold that appellant is a seller under the Act." (A. 12)

On this basis the Court of Appeals went on to rule that Vine could maintain a class action on behalf of the Class A stockholders. It noted that Vine still held his Class A stock but rejected defendant's contention

that this precluded him from being considered a "seller" of securities under the Act. Without mentioning Vine's obvious reason for not turning in his certificate, i.e., his desire to preserve his technical standing as a stockholder bringing a derivative action, the Court of Appeals said:

> "Since, in order to realize any value for his stock, appellant must exchange the shares for money from appellee, as a practical matter appellant must eventually become a party to a 'sale', as that term has always been used. . . . It is true that appellant still has his stock; if he turned it in . . ., it would be clearer that appellant is a seller. Assuming that this would not otherwise affect his right to sue under the Act and the Rule, requiring him to do so as a condition to suit seems a needless formality.
>
> "We do not construe the Act so narrowly." (A. 10-11)

Thus, as in *J. I. Case Co.* v. *Borak*, 377 U.S. 426 (1964), a party, not personally "defrauded" in a formalistic sense was permitted to represent his class—in the instant case as a forced seller. When the short-form merger occurred, Vine's equity interest in a going business became a piece of paper entitling him to cash, $3.29 per share. The fraud practiced upon him cancelled his equity and forced him to surrender his certificate for cash. The last link in the three stage plan was the short-form merger. The scheme of fraud worked on all the remaining public stockholders of Crown, and the Second Circuit said that Vine could bring this action on behalf of all

the public stockholders caught up in the same scheme. As this Court has said previously:

> "The damage suffered results not from the deceit practiced on him [the small stockholder] alone but rather from the deceit practiced on the stockholders as a group. Private enforcement of the . . . rules provides a necessary supplement to Commission action. As in anti-trust treble damage litigation, the possibility of civil damages or injunctive relief serves as a most effective weapon in the enforcement of the proxy requirements." *J. I. Case Co.* v. *Borak,* 377 U.S. 426, 432 (1964)

II

The decision below is in accord with those of other courts including those of this Court. *SEC* v. *Capital Gains Research Bureau, Inc., supra; J. I. Case Co.* v. *Borak, supra.*

Two cases, strikingly parallel to the case at bar, have been decided similarly in the last few years. In *Voege* v. *American Sumatra Tobacco Corp.,* 241 F. Supp. 369 (D. Del. 1965), the Court sitting in the state of Crown's incorporation, ruled on a motion to dismiss the complaint, that derivative and representative actions would lie where, the controlling interests of "Old Company" had perpetrated a scheme almost identical to the one at bar. In *Voege* the controlling group made a tender offer, obtained sufficient shares to effect a short-form merger under Delaware law, merged "Old Company" into "New Company" and

forced the minority stockholders to take dollars for their shares. The plaintiff alleged fraud in violation of Rule 10b-5 in the tender offer as part of the entire scheme to force minority stockholders to take cash for their stock. The only response petitioner could make to this precedent on all fours with the instant case was to argue that it was wrong, and "flies in the face of the Act." Where the Courts below in the case at bar were both satisfied to rest their decisions upon interpretation of the Act, in *Voege* the Court sitting in Delaware, theorized that under Delaware law the certificate of incorporation was indeed a contract pursuant to which

> ". . . in net effect when plaintiff bought her shares, she agreed that in the event of a merger the corporation surviving the merger should have an option to buy her shares at a price to be determined in the future.
>
> "The frauds allegedly perpetrated upon plaintiff were, in a very real sense, related to a vital part of the contract (the fixation of the purchase price) under which plaintiff had agreed to sell. They were committed "in connection with the purchase [and] sale" of a security within the meaning of Rule 10b-5. Any other view would defeat the purpose of Rule 10b-5 . . . *Voege* v. *American Sumatra Tobacco Corp., supra* at 374.

And in *Dasho* v. *Susquehanna Corp.*, 380 F. 2d 262 (7th Cir., 1967) pet. for cert. filed sub nom *Bard* v. *Dasho,* Sept. 25, 1967, the Court had before it a derivative action where minority stockholders of a corporation merged into another company were being forced by the merger to take new company shares for

their old company shares. The only difference between *Dasho* and the instant case is that shares were exchanged for shares therein, and shares were exchanged for cash in the instant case. In *Dasho* the Court held that a public stockholder caught up in the merger was a "seller" of securities for purposes of Rule 10b-5, noting

> "Our attention is called to Sections 3(a) (13) and 3(a)(14) of the Exchange Act, . . . which define the word 'purchase' to 'include any contract to buy, purchase, or otherwise acquire', and 'sale' to 'include any contract to sell or otherwise dispose of'. This broad language indicates an intention by Congress that the words 'purchase' and 'sale' are not limited to transactions ordinarily governed by the commercial law of sales. The purpose is evidently to make control of securities transactions reasonably complete and effective to accomplish the purpose of the legislation." *Dasho* v. *Susquehanna Corp.*, 380 F.2d at 266.

The Court in *Dasho* relied in part upon *SEC* v. *W. J. Howey Co.*, 328 U.S. 293 (1946) which defined the term "investment contract" in the Securities Act of 1933 ("the 1933 Act"). The *Dasho* court recognized that the securities laws required:

> ". . . a flexible rather than a static principle, one that is capable of adaptation to meet the countless and variable schemes devised by those who seek the use of the money of others on the promise of profits." 380 F.2d at 267 (quoting *SEC* v. *W. J. Howey Co., supra* at 299)

In this context the *Dasho* court met the merger-sale problem head-on. It reasoned that in the federal securities law area the words "seller" and "purchaser" were never intended to be limited to the conceptional framework surrounding them at common law. In *Wilko* v. *Swan*, 346 U.S. 427 (1953), this court refused to so limit those words as they appear in the 1933 Act. The 1934 Act was intended to extend the zone for the protection of investors initiated by the 1933 Act. The *Dasho* court held therefore that the language in the 1934 Act parallel to that used in the 1933 Act cannot be deemed to revert to the abandoned limiting concepts of the common law. It noted that investors, enmeshed in the complex mechanics of a merger with its opportunities for fraud, needed the protection of the Act as much as investors selling for cash in an open market transaction.

In the instant short-form merger case, there is an additional element of compulsion lacking in ordinary mergers. The public stockholders are being forced out of the business by being given cash instead of securities in the continuing enterprise. Deception of the public at an earlier stage in the scheme put the last few stockholders in a position where they had to sell their securities.

The thinking of the Second Circuit in the case at bar and of the Seventh Circuit in *Dasho* are simply applications of existing federal securities law. Forced sellers in similar situations have long been able to obtain redress for their grievances under the anti-fraud provisions of the 1933 Act and the 1934 Act. Plaintiffs were able to maintain their actions under the anti-fraud provisions of the securities laws in *Speed* v.

Transamerica Corp., 235 F.2d 369 (3rd Cir., 1956) and *Zahn* v. *Transamerica Corp.*, 162 F.2d 36 (3rd Cir., 1947) where they were being forced to turn in their preferred stock in an involuntary redemption of those shares. The Third Circuit is where Rule 10b-5 civil liability originated, and the Delaware District Court sitting in *Voege* v. *American Sumatra Tobacco Corp., supra*, was continuing its tradition of applying the broad definitions of the Act to all forms of deceptive practices in securities.

In *Hooper* v. *Mountain States Securities Corp.*, 282 F.2d 195 (5th Cir., 1960) the Fifth Circuit held that a corporation's issuance of stock in return for assets constituted a sale of securities for purposes of Rule 10b-5. In *Ruckle* v. *Roto American Corp.*, 339 F.2d 24 (2d Cir., 1964), the Second Circuit held there was a sale of securities where the corporation was in the process of being misled by some of its own directors into issuing its treasury stock; the stock had not yet been "sold" when injunctive relief was granted under Rule 10b-5. In *Blau* v. *Hodgkinson*, 100 F.Supp. 361 (S.D.N.Y., 1951) the District Court decided that an exchange of stock in a subsidiary for that of a parent in a corporate reorganization was a contract to "sell" securities.

The strongest precedent petitioner could muster in support of its position is an outworn theory that "volition" is required for a sale of securities, contained in an amicus brief filed by the S.E.C. twenty-five years ago in the Ninth Circuit. In the instant case, the S.E.C. strongly urged that the short form merger herein resulted in a purchase and sale of Vine's stock within the meaning of Rule 10b-5. The

compulsion implicit in mergers is one of the strongest reasons for making securities transactions therein subject to the fraud statutes. What the petitioner is trying to do is to persuade this Court to overturn the law in this area exemplified by the decisions of the Second, Third, Fifth and Seventh Circuits. There is complete harmony among all of the Circuit Courts which have considered the issues of law herein. The technical area narrowly explored in *Vine* hardly makes it an appropriate vehicle for attenuating well established principles in this field.

III

The Second Circuit has already recognized that, in the case at bar, it has merely added a slight precedent in its attempt to define the area in which Rule 10b-5 is properly operative.

> "... various concepts have been utilized to limit liability under the sweeping language of the Rule, although none is specifically required by it.[1] Thus a requirement of privity was at first suggested[1] but has more recently been ignored.[1] However the search for limiting doctrine has continued.[1] Thus, some courts have looked to see whether a plaintiff actually relied on the allegedly fraudulent statement,[1] whether such reliance was reasonable,[1] whether the fraud actually caused harm to plaintiff,[1] whether the plaintiff's injury was foreseeable,[1 2] and whether plaintiff falls within the category of a buyer or a seller of securities.[1 2]" *Mutual Shares Corp.* v. *Genesco*

[1] Citations and citation footnotes omitted.

[2] Citing *Vine*, the case at bar.

Inc.—F.2d.—(2d Cir., 1967), CCH Fed. Sec. Law Rep. par. 91,983 at p. 96,343

In citing *Vine* since it was decided, the tendency has been to limit the decision:

> ". . . the offer to stockholders [in *Vine*] was made by insiders; plaintiff Vine was a member of the class to whom the offer was specifically addressed; and the issue decided was whether Vine was an involuntary 'seller' because the corporation in which he owned stock had been dissolved, leaving him only with shares which had been converted into a claim for cash." *Mutual Shares Corp.* v. *Genesco, Inc., supra,* CCH Fed. Sec. Law Rep. par. 91,983 at p. 96,344.

A. T. Brod & Co. v. *Perlow,* 375 F.2d 393 (2d Cir., 1967); *Symington Wayne Corp.* v. *Dresser Industries, Inc.,* —F.2d— (2d Cir., 1967), CCH Fed. Sec. Law Rep. par. 91,978. Compare *Dasho* v. *Suquehanna Corp., supra.*

The Southern District of New York has similarly read the opinion in this limited way. *Pacific Insurance Co.* v. *Blot,* 267 F. Supp. 956 (S.D.N.Y., 1967).

IV

In *Vine* the Second Circuit did not go as far as was advocated by the Securities and Exchange Commission, an organization whose special province and expertise in this area has long been recognized by this Court. *SEC* v. *U. S. Realty & Imp. Co.,* 310 U.S. 434, 448-9 (1940). In its brief below, the Securities and Exchange Commission argued:

"The purpose of Section 10(b) of the Securities Exchange Act and of Rule 10b-5 is to protect security holders; appellant, as a stockholder of Crown, is entitled to the protections therein. The fact that damages are sought not by a selling stockholder but by another stockholder of the same company, claiming damages flowing from a loss of value in his stock by reason of the violation should be no ground for failure to apply the general rule that persons for whose benefit the statute was enacted may sue for damages caused them by its violation.[1]

"The Supreme Court has held that a stockholder may bring a cause of action based on comparable provisions of the Commission's proxy rules, even though the stockholder was not himself misled by the false statements in the proxy soliciting material that constituted the alleged violation." *Borak* v. *J. I: Case Co.* . . . In that case, as in this, the plaintiff alleged injury by reason of a merger brought about through use of misleading statements in violation of the Securities Exchange Act and the Commission's rules thereunder. The court made clear that if the plaintiff should be able to prove a 'causal relationship of the proxy material and the merger' . . . and that the merger resulted from fraud or was non-beneficial, plaintiff was entitled to relief. The Court also held that the right of action existed as to 'both derivative and direct causes'. . . . S.E.C. Brief, Respondent's Appendix 21-2.

Instead of following this "investor" theory, the Court of Appeals accepted, almost verbatim, the

[1] Footnote omitted.

S.E.C.'s interpretation of "sale" and "purchase" in sections 3(a) 13 and 3(a) 14 of the Act, 15 U.S.C. 78c(a)13, 78c(a)14. See also *Entel* v. *Allan*, 270 F. Supp. 60 (S.D.N.Y., 1967).

The Commission argued below (and presumably in its amicus brief in *Dasho*) that Congress made clear by its broad language in Sections 3(a)(13) and 3(a)-(14) of the Act, that it did not intend to limit the application of the 1934 Act to the concepts of sale ordinarily applicable in the commercial sphere. If it had so intended, it would not have defined purchase and sale to "include" contracts to buy and sell, and added "or otherwise" acquire or dispose of. As the S.E.C. said Congress intended to protect investors from the myriad possibilities of fraud and expected the law to do the job in a "reasonably complete and effective manner." Section 2, 1934 Act, 15 U.S.C. 78(b). The words "include" and "or otherwise" were placed in the statute to express its intended breadth; they cannot be read out of it. S.E.C. brief, Respondent's Appendix 22.

V

The decision below was correct in giving Vine the right, two years after filing his complaint, to go forward and prove his case. Section 10b and Rule 10b-5 are at the heart of the 1934 Act. The prohibition against the use of "any device, scheme, or artifice to defraud" or "the making of any untrue statement of a material fact" in any securities transaction is the very essence of the law, in that they are designed to cover plans as imaginative as that used by Beneficial

in the instant case—schemes that take several seemingly unrelated steps, schemes that euchre public stockholders out of the way so that other stockholders can be forced out. They are words whose interpretation is uniquely suited to the careful advance through the case by case method of the common law. This conservative tradition is the path the courts are following. *Mutual Shares Corp.* v. *Genesco, supra.* The Second Circuit has shown no enthusiasm for opening the gates in New York City to more securities fraud litigation than exists now by expanding the coverage of Rule 10b-5. The "parade of horrors" in Petitioner's brief are distortions of the problems of proof in a case such as this. Most of the evidence will be documentary, and the misleading representations were circulated on a uniform basis, in writing, to all stockholders. The deception of the public stockholders will be as self-evident as Beneficial's close relationship to Crown's "insiders" for some twenty years.

According to the complaint herein, defendants schemed and misled to defraud the very persons the Act is intended to protect, public stockholders. As a result of their machinations, Vine and those similarly situated were forced to give up what they had purchased—the right to risk their savings in a going concern. The Second Circuit below has simply ruled that if Vine can prove his allegations of fraud under Rule 10b-5, he and his class can recover. There is nothing startling about this concept, it is plainly based on the precedents of this Court and of the circuits. There is no real conflict in opinions and the decision is properly limited to the well-expounded facts in a narrow opinion rendered in the common law tradition. Certiorari is not appropriate.

CONCLUSION

The petition for a writ of certiorari should be denied since no ground of the character specified in Rule 19 of this Court applies.

Respectfully submitted,

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of Counsel

CONCLUSION

The petition for a writ of certiorari should be denied since no grounds of the character specified in Rule 19 of this Court appear.

Respectfully submitted,

Lawrence M. Cox

APPENDIX

Amended Complaint

UNITED STATES DISTRICT COURT

SOUTHERN DISTRICT OF NEW YORK

Civil Action No. 3050/65

LEO VINE,

Plaintiff,

—against—

BENEFICIAL FINANCE COMPANY, INC., CHARLES H. DOWD, STUART A. WIXSON, GEORGE J. SPRINGER, C. H. DONOHUE, and CROWN FINANCE COMPANY, INC.,

Defendants.

Plaintiff, for his Complaint, hereby alleges as follows:

1. (a) Plaintiff bases his claim herein upon Section 10b of the Securities and Exchange Act of 1934, 15 U.S.C. 78i(b) and Rule X-10b-5 promulgated thereunder by the Securities and Exchange Commission.

(b) The jurisdiction of the court herein is based upon Section 27 of the Securities and Exchange Act of 1934, 15 U.S.C. 78 aa.

2. (a) The Plaintiff is a citizen and resident of New York, and the Defendants Beneficial Finance Company, Inc. (hereinafter called "Beneficial") and Crown Finance Company, Inc. (hereinafter called "Crown") are corporations organized under the laws of Delaware with their principal offices in Wilmington, Delaware; the individual Defendants are, to Plaintiff's information and belief, regularly employed at the offices of Beneficial and Crown in

Delaware, but Plaintiff does not know the several states in which such individuals now reside.

(b) The matter in controversy herein, exclusive of interest and costs, exceeds the sum of $10,000, and Plaintiff submits the matters hereinafter set forth to the jurisdiction of this court on the additional basis of diversity of citizenship, pursuant to 28 U.S.C. 1332.

3. (a) The Plaintiff is the record owner of 100 shares of the Class A Common Stock of Crown, (hereinafter called the "Class A stock"), and owned such shares long prior to and at the time of the wrongs complained of herein.

(b) The Plaintiff brings this action derivatively on behalf of Crown and all of its Class A stockholders existing at the time of the wrongs complained of herein, and Plaintiff is a proper representative of such class.

(c) This action is not a collusive one to confer on a Court of the United States jurisdiction of any action of which it would not otherwise have jurisdiction.

4. The Defendant Beneficial acting in concert with the individual Defendants, who are officers and directors of Crown and who were the principal holders of the Class B Common Stock of Crown (hereinafter called the "Class B stock"), undertook a fraudulent scheme directed against the corporation and the Class A stockholders of Crown. The scheme was to appropriate to the holders of the Class B stock of Crown a cash sum of approximately $900,000 which would otherwise have been paid to the Class A stockholders of Crown, and to merge Crown into Beneficial for a total cash consideration of at least $800,000 less than the fair market value of Crown as a going business. Such scheme and conspiracy resulting in the unjust en-

richment of the Class B stockholders and Defendant Beneficial at the expense of the Class A stockholders is hereinafter described in detail.

5. (a) Crown is a Delaware corporation which has two classes of common stock. The Class A stock and the Class B stock have equal voting rights on all matters placed before stockholders except that the Class A stock has the right to designate one-third of the directors of the corporation, and the holders of the Class B stock have the right to designate two-thirds of the directors of the corporation. With respect to a merger, sale of assets or changes in the corporate charter, the holders of both classes of stock have the same voting rights share for share.

(b) The rights of the Class A stockholders and the Class B stockholders in the liquidation of the corporation were that each share of Class B stock would be equal to one-tenth of a share of Class A stock, and thus it took ten shares of Class B stock to have an equivalent claim on assets in liquidation to that of one share of Class A stock. In addition, Class A stock as a class has the right to receive 80% of the total sum set aside for payment of cash dividends at any time, and the remaining 20% of such sum is payable to Class B stock as a class.

(c) During all times hereinafter mentioned, Crown had 624,870 shares of Class A stock outstanding, and 46,500 shares of Class B stock outstanding.

6. (a) During the Spring and Summer of 1963, Defendant Beneficial, which is a very large corporation listed on the New York Stock Exchange, entered into negotiations for acquisition of Crown, a small company with limited over-the-counter trading in its stock, with a view

towards buying the business of Crown as a going enterprise and merging such business into Beneficial. Both Beneficial and Crown are in the same business, which is the operation of small loan and personal finance offices, and the location of the Defendant Crown's finance offices in New York, Connecticut, Massachusetts and New Jersey, constituted an attractive merger possibility for the Defendant Beneficial.

(b) In connection with negotiations for the acquisition of the business of Crown, Beneficial, to Plaintiff's information and belief, determined that it would like to acquire Crown as a going business and merge it into Beneficial at a cash cost equal to the approximate amount of its book net worth. The book net worth of Crown as at June 30, 1963 was $1,681,601, without giving any value to its good will as a going enterprise, in business for over 25 years.

(c) Beneficial is a corporation with over one billion dollars in assets, and to Plaintiff's information and belief, intended to buy Crown only if it could be merged into Beneficial and operated as part of Beneficial.

7. The officers and directors of Crown, who owned virtually all of its Class B stock, i.e. the controlling bloc of stock solely by reason of their ability to designate a majority of the board of directors, realized that Beneficial was willing to pay at least the $1,700,000 book net worth of Crown, to acquire its business. These holders of Class B stock therefore embarked upon a scheme and conspiracy with Beneficial, to divert this corporate opportunity for sale of the business and merger into Beneficial to themselves, by selling Crown at a price lower than its fair market value, and appropriating the bulk of the cash consideration to the holders of the Class B

stock, leaving a minimum amount for payment to the holders of the Class A stock.

8. The individual Defendants, as controlling officers and directors held 42,916 shares of the Class B stock and approximately 1,187 shares of the Class A stock, and were minority shareholders as a result. The aggregate claim on the book net worth of Crown of the 46,500 shares held by the Class B stockholders as at June 30, 1963, consisted of approximately $12,500. The aggregate claim on the book net worth of the 624,870 shares held by the Class A stockholders on June 30, 1963 consisted of approximately $1,670,000.

(a) Had Beneficial pursued its merger plans directly, and (i) offered to merge Crown into Beneficial, giving Crown's shareholders cash in exchange for their stock, or (ii) offered to buy all of Crown's assets for cash, followed by Crown's liquidation into the hands of its shareholders, the Class A stockholders would, in either case, have voted share and share alike with the Class B stockholders on these corporate transactions. The overwhelming voting superiority of the Class A shares would have prevented any merger or sale of assets which gave grossly disportionate proceeds to the holders of Class B shares. A merger or sale of assets required approval of 66⅔% of all stockholders, and there were 624,870 Class A shares and 46,500 Class B shares which would have voted share for share alike. In a merger or sale of assets recommended by unselfish directors properly pursuing the interests of the corporation, and voted on by all shareholders, the Class A shareholders would necessarily have received approximately $1,670,000 and the Class B shareholders some $12,500. Moreover, in a good faith merger or sale of assets, the buyer of

Crown would have been required to pay something more than merely the book net worth of this well established loan company.

(b) The holders of the Class B stock of Crown conducted the initial discussions and controlled all of the negotiations with Beneficial, by reason of their fiduciary position as directors and officers of Crown. Using this fiduciary position in the negotiations, these holders of Class B stock, to Plaintiff's information and belief, diverted the corporation's opportunity to merge or sell its assets and entered into a conspiracy with Beneficial to shape the transaction in such a way that the holders of the Class B stock were paid the sum of approximately $700,000 for a purchase of their shares, plus an aggregate of some $200,000 in benefits under employment and consulting agreements, instead of the $12,500 to which they were entitled in the merger. As part of this scheme, the holders of the Class A stock were offered and paid, an aggregate of approximately $800,000 for their stock as a class, instead of some $1,670,000 to which they were entitled in the merger.

(c) Defendant Beneficial knowingly entered into the aforesaid conspiracy with the Class B stockholders of Crown on or about August 5, 1963, with the purpose and intention of defrauding the holders of the Class A stock of Crown out of their proper participation in the proceeds of the sale of its business and merger into Beneficial. Beneficial's motive, to Plaintiff's information and belief, was to keep the overall cash cost of the merger down by grossly overpaying one class of stock which had few shares outstanding and grossly underpaying the other class of stock which had many shares outstanding. Such merger is now in the process of completion on a statutory basis, and as a result of this conspiracy, Beneficial owns

Crown for at least $300,000 less than its true value as a going business.

9. (a) In connection with the aforesaid transaction, Beneficial made an offer to purchase all of the shares of the Class A stock of Crown, which had not previously been acquired from the controlling group of shareholders who held the Class B shares of Crown. Such offer was made in writing by Beneficial commencing August 19, 1963, for the purchase of 521,146 shares of Class A stock of Crown for $1.25 per share, and such offer was increased to $2.50 per share pursuant to an offer sent out to all remaining Class A stockholders of Crown on January 18, 1965.

(b) The overall scheme of purchase and merger herein alleged, which included several offers made by Beneficial which were accepted by several Class A stockholders of Crown, who did not know the true facts, and were not accepted by other Class A stockholders of Crown, constituted, directly or indirectly, (1) devices, schemes or artifices to defraud, (2) the making of untrue statements of material facts and omissions to state material facts necessary to make the said Defendants' statements, in the light in which they were made, not misleading, and (3) engaging in acts, practices and a course of business which operated as a fraud and deceit upon the Class A stockholders of Crown, in connection with the offer to purchase and the purchase of their Class A stock from them. Among other things such offers, as part of the overall scheme, contained materially misleading financial information on Crown, omitted material information which would have apprised Class A shareholders of their rights in the acquisition of their company and were an integral part of the scheme of fraudulent

acquisition and merger being practiced on all Class A stockholders by Beneficial and the Class B stockholders.

10. The Defendants have used means and instrumentalities of interstate commerce and of the mails in connection with the foregoing fraudulent acts which are violations of the statute of the United States set forth in paragraph 1 of this Complaint, and also constitute fraud and deceit under the laws of Delaware and New York.

11. The aforesaid offer to the Class A stockholders of Crown was made in writing by Beneficial, at $1.25 per share after Beneficial had agreed to purchase the stock of the Class B stockholders of Crown for approximately $15.00 per share. In terms of the relative rights of the two classes of stock, the Class B stockholders were paid a premium of at least 1200% for the right to designate a majority of the directors which was appurtenant to their shares. Class B shareholders were paid a total of $695,000 for the Class B shares which had a claim against the assets of Crown in a merger or liquidation of about $12,500. In addition the holders of Class B shares received lucrative employment and consulting agreements from Beneficial and Crown aggregating to some $200,000 as additional compensation. Defendant Beneficial received at least $300,000 in tangible assets without paying for them, and to Plaintiff's information and belief, the going business value of Crown was worth at least $500,000 which was not paid for by Beneficial.

12. Since the acquisition of Crown by Beneficial, Beneficial has embarked on a course of conduct to further derogate the value of the Class A stock of Crown, and further attenuate the rights of the holders thereof, including but not limited to, the following acts:

(a) Beneficial and the individual Defendants have for no valid business reason caused Crown to refrain from paying any dividends, notwithstanding a continuous payment of dividends by Crown from 1951 through 1962, and no dividends have been paid since Beneficial acquired Crown.

(b) Beneficial has tampered with the methods of accounting previously applied on a consistent basis by Crown by fictitiously increasing reserves for bad accounts and making other accounting entries which make it appear that Crown is losing substantial sums of money from operations since its acquisition by Beneficial, and is therefore a non-remunerative investment for its Class A stockholders. In fact, the business of Crown has continued virtually unchanged since its acquisition by Beneficial, except for profitable sell-offs of several branch offices at nearly $300,000 more than the book value paid for these tangible assets by Beneficial.

(c) Beneficial has, to Plaintiff's information and belief, caused Crown to enter into a Management Agreement with a subsidiary of Beneficial, Beneficial Management Corporation, which sells administrative and legal services to Crown at prices which further cause a diminution in the annual earnings of Crown, and are duplicative of services being rendered to Crown by its existing officers.

(d) Beneficial has continued to compensate the holders of Class B stock which joined with it in this conspiracy, by keeping them on employment and consulting agreements at substantial salaries with little or no services performed to Crown.

(e) Beneficial is currently engaged in merging Crown into Beneficial on a basis which pays the minority stockholders of Crown $3.29 in cash per share, with no

further interest in the corporation or the successor corporation, Beneficial, after the merger, thus completing the fraudulent scheme for exclusion of the Class A stockholders of Crown from participation in the going business value of their Company.

13. (a) At the initiation of the fraudulent scheme, Beneficial held out to the Class A stockholders in a written offer to purchase that their stock was reasonably worth $1.25 per share and should be sold for that price, and two years later, after showing losses and withholding dividends, Beneficial has stated to the Class A stockholders of Crown that in its opinion, their stock is now worth nearly 300% more, $3.29 per share, in the merger, placing a value of over $2,000,000 on the net tangible equity of Crown, without giving any value to good will.

(b) In truth and in fact, the substantive merger was completed by the fraudulent scheme occurring in August, 1963, and the statutory merger where the fair market value of the 624,687 shares of Class A stock would have been recognized was intentionally delayed until most of the Class A stockholders had been fraudulently induced to sell their stock. The Class A stockholders who sold out were defrauded, the Class A stockholders who remained were defrauded and the Class A stockholders who exercised their appraisal rights in the merger now in process have also been defrauded by this single scheme.

14. By reason of the aforesaid conspiracy, and the steps taken in the pursuance thereof, all of the Defendants are in pari delicto with each other, and are jointly and severally liable, responsible and accountable to the Class A stockholders of Crown and to such corporation for the acts and harm which has occurred to date. All of the aforesaid corporate acts and transactions by the Defend-

ants arising out of their conspiracy and plan to defraud the Class A stockholders of Crown are illegal and void under the laws of Delaware, New York and the United States.

15. This action is instituted by the Plaintiff stockholder on behalf of the corporation Crown because it would be futile to request the President of such corporation to institute said action, due to the domination and control exercised over it by the Defendant Beneficial. Corporate steps now in process by the Defendants to merge Crown into Beneficial and pay remaining Class A stockholders in cash are part of the plan and conspiracy complained of herein, and the only surviving corporate entity will be or may now be the wrongdoer, Defendant Beneficial.

16. Plaintiff has incurred and will continue to incur substantial attorneys' fees and expenses in the bringing of this action on behalf of himself and all other stockholders of Crown similarly situated.

WHEREFORE, Plaintiff demands the following:

(1) Judgment against Beneficial and the individual Defendants for $1,700,000 damages in favor of Crown, plus whatever additional sum Crown's assets were in fact worth when control of them was acquired by Beneficial, with interest from July 29, 1963 and punitive damages in the sum of $2,000,000 together with the amount of any additional damages suffered by Crown and its Class A stockholders prior to the satisfaction of any judgment entered herein, all such monies to be set aside and paid pro rata to all holders of Crown's Class A stock, except for those holders who participated in the wrongs to the corporation complained of herein,

(2) An order awarding Plaintiff his reasonable attorneys' fees herein together with costs and disbursements in this action, and

(3) An order awarding Plaintiff such other and further relief as shall be just and proper in the premises.

Dated: New York, New York
November 4, 1965

BERMAN & POWERS
Attorneys for Plaintiff

By /S/ LAWRENCE M. POWERS
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(Verified)

BRIEF OF THE SECURITIES AND EXCHANGE COMMISSION BELOW

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

No. 30,500

LEO VINE,

Plaintiff-Appellant,

v.

BENEFICIAL FINANCE COMPANY, INC.,

Defendant-Appellee,

and

CHARLES H. DOWD, STUART A. WIXSON, GEORGE J. SPRINGER, C. H. DONOHUE and CROWN FINANCE COMPANY, INC.,

Defendants.

BRIEF FOR THE SECURITIES AND EXCHANGE COMMISSION, AMICUS CURIAE

On October 18, 1966, this Court requested the Securities and Exchange Commission ("Commission") to file a brief in this appeal to express its views on the interpretation of Rule 10b-5 under the Securities Exchange Act of 1934 at issue.

Statement of the Case

Appellant, the owner of 100 shares of Class A common stock of Crown Finance Company, Inc. ("Crown"), a Delaware corporation, brought this action for damages based upon Section 10(b) of the Securities Exchange Act

of 1934 ("Securities Exchange Act"), 15 U.S.C. 78j(b), and Rule 10b-5 thereunder, 17 CFR 240.10b-5. The amended complaint alleges that Beneficial Finance Company, Inc. ("Beneficial") and the individual defendants, who are former directors of Crown, entered into a fraudulent scheme to merge Crown into Beneficial. The pertinent allegations of the amended complaint may be summarized as follows:

Prior to the merger Crown had outstanding two classes of stock, Class A and Class B. Each class had equal voting rights, except that the holders of Class B stock as a class were entitled to elect two-thirds of the members of the board of directors (14a).[1] The Class B stock was held by the directors of Crown (15a). The Class A stock was outstanding in the hands of public shareholders. In 1963 Beneficial and the directors of Crown who owned the Class B stock allegedly entered into a fraudulent scheme for the merger of Crown into Beneficial whereby Beneficial would acquire the assets of Crown for a total consideration less than the fair market value of Crown as a going business (13a, 14a). As a result of this scheme, the Class B stockholders who conspired with Beneficial received substantial cash consideration for their shares while the public Class A stockholders received insufficient consideration for their shares (15a, 16a). The alleged scheme involved three steps:

(1) Beneficial purchased the Crown Class B stock from the directors of Crown for approximately $15 per share for a total consideration of $900,000 (17a, 19a).

(2) Beneficial made a tender offer to Class A shareholders at $1.25 per share, which was later increased to $2.50 per share in a subsequent tender offer, and purchased sufficient shares to acquire 95% of the Class A

[1] "a" refers to the appendix to appellant's brief [in the Court of Appeals].

stock for a total of $800,000 (18a). "Among other things," it is alleged, "such offers, as part of the overall scheme, contained materially misleading financial information on Crown, omitted material information which would have apprised Class A shareholders of their rights in the acquisition of their company and were an integral part of the scheme of fraudulent acquisition and merger being practiced on all Class A stockholders by Beneficial and the Class B stockholders" (18a-19a).

(3) Beneficial caused a short form merger of Crown with a wholly-owned New York subsidiary of Beneficial under Section 905 of the New York Business Corporation Law, pursuant to a plan of merger which provided for payment to minority shareholders for their stock on the basis of $3.29 per share in cash (17a, 20a-21a).[2]

As a result of the alleged fraudulent scheme of merger, Beneficial was able to acquire Crown for a total consideration of $1,700,000, at least $800,000 below the worth of the company as a going concern (13a).

On the motion of Beneficial, the court below dismissed the amended complaint holding, *inter alia,* that it failed to state a cause of action under Section 10(b) and Rule 10b-5 thereunder since it failed to show that appellant was a seller of securities.

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[2] Section 905 of the New York Business Corporation Law provides that a corporation owning at least 95% of the outstanding stock of another corporation may merge such other corporation into itself without the authorization of the shareholders of such other corporation upon approval of a plan of merger by the board of directors of the surviving corporation, a copy of which must be provided to all shareholders of the subsidiary corporation, and filing of articles of merger with the state. A short form merger of a domestic and foreign corporation is permitted under Section 907 of the New York Business Corporation law if such form of merger is also permitted under the laws of the state of foreign incorporation. A short form merger is permitted under 8 Del. Code § 253.

ARGUMENT

Purchases through False Representations by One Corporation of Sufficient Shares of Another Corporation to Permit the Former to Effectuate a Short Form Merger with the Latter, So That the Remaining Stockholders of the Latter Cease to Have a Stock Interest in Either Corporation, Created a Cause of Action on Their Behalf under Section 10(b) of the Securities Exchange Act and Rule 10b-5 for Damages Caused Thereby.

It is the Commission's view that any damages resulting to appellant from the series of transactions alleged should be recoverable under Section 10(b) of the Securities Exchange Act and Rule 10b-5 thereunder on the basis of either of two theories: (1) such damages flow directly from Beneficial's alleged violations of Rule 10b-5 in connection with its purchases of stock from Class A stockholders of Crown pursuant to its tender offers and (2) the merger, whereby appellant's stock ceased to constitute an interest in Crown as a viable corporation, itself resulted in a purchase of that stock within the meaning of Rule 10b-5 brought about by Beneficial's alleged fraudulent scheme.

1. It is alleged that the purchases of Crown stock pursuant to the tender offers were effected by fraudulent misrepresentations—a clear violation of Rule 10b-5. Since these purchases enabled Beneficial to meet the conditions for the short form merger, which appellant contends resulted in injury to him, on proof of these allegations appellant should be able to recover his damages from Beneficial. That he may not have been misled by the false representations made by Beneficial in connection with its tender offers is no reason for precluding his recovery for injury he has sustained as a result thereof. The situation is not comparable to *List* v. *Fashion Park, Inc.*, 340 F.2d 457 (C.A. 2, 1965), *certiorari denied*, 382 U.S. 811 (1965),

where this Court held that the plaintiff was required to prove reliance on the misleading non-disclosures because in that action there could have been no injury in the absence of such reliance.[3] Nor is the situation here comparable to *Birnbaum* v. *Newport Steel Corp.*, 193 F.2d 461 (C.A. 2, 1952), *certiorari denied*, 343 U.S. 956 (1952), or to *O'Neill* v. *Maytag*, 339 F.2d 764 (C.A. 2, 1964). In those cases it was held that there was no deception practiced upon the parties to the securities transactions and that, therefore, there was no violation of Rule 10b-5. In *Maytag* there was no deception on the decision-making group, here there was. The fraud in *Maytag* was on the corporation but the corporation was not deceived. Here the fraud was on the Class A shareholders who sold pursuant to the tenders and they were allegedly deceived.

The purpose of Section 10(b) of the Securities Exchange Act and of Rule 10b-5 is to protect security holders; appellant, as a stockholder of Crown, is entitled to the protections therein. The fact that damages are sought not by a selling stockholder but by another stockholder of the same company, claiming damages flowing from a loss of value in his stock by reason of the violation, should be no ground for failure to apply the general rule that persons for whose benefit the statute was enacted may sue for damages caused them by its violation.[4]

The Supreme Court has held that a stockholder may bring a cause of action based on comparable provisions of the Commission's proxy rules, even though the stockholder was not himself misled by the false statements in

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[3] Of course, appellant's action here would fall if it should be found that those who sold pursuant to the tender offers would have done so despite the allegedly misleading representations or omissions.

[4] *Borak* v. *J. I. Case Co.*, 377 U.S. 426 (1964); *Fischman* v. *Raytheon Mfg. Co.*, 188 F.2d 783 (C.A. 2, 1951).

the proxy soliciting material that constituted the alleged violation. *Borak* v. *J. I. Case Co.*, 377 U.S. 425 (1964). In that case, as in this, the plaintiff alleged injury by reason of a merger brought about through use of misleading statements in violation of the Securities Exchange Act and the Commission's rules thereunder. The court made clear that if the plaintiff should be able to prove a "causal relationship of the proxy material and the merger", *Id* at 436, and that the merger resulted from fraud or was non-beneficial, plaintiff was entitled to relief. The court also held that the right of action existed as to "both derivative and direct causes." *Ibid.* Similarly, here the complaint seeks relief both derivatively and directly.

2. In any event, the merger by which plaintiff ceased to have rights as a stockholder of Crown involved a purchase and sale of securities, as those terms are broadly defined in the Securities Exchange Act, and was brought about by Beneficial's alleged fraudulent scheme. Section 3(a)(14) of the Securities Exchange Act, 15 U.S.C. 78c(a)(14), provides that a "sale" includes "any contract to sell or otherwise dispose of" securities and Section 3(a)(13), 15 U.S.C. 78c(a)(13), provides that a "purchase" includes "any contract to buy, purchase, or otherwise acquire" securities. Congress thereby made clear that these concepts embrace transactions beyond the limitations ordinarily applicable under the commercial law of sales in order to effectuate a primary purpose of the Act expressed in Section 2, 15 U.S.C. 78b, to make the "regulation and control" of transactions in securities "reasonably complete and effective."

The disposition of the outstanding shares of Crown held by the minority shareholders pursuant to the short form merger of Crown into Beneficial falls within these definitions since appellant's rights as a shareholder of Crown

were extinguished by the merger of Crown into Beneficial.[5] When appellant acquired his Crown stock he agreed by virtue of the applicable provisions of Delaware corporation law that if the statutory conditions precedent to effect a short form merger should be satisfied, the surviving corporation would have, in effect, an option to purchase his shares at a price and upon terms and conditions to be determined by the plan of merger.[6] The plan of merger was, in effect, the exercise of that option by Beneficial and as such resulted in a purchase of securities within the meaning of the Securities Exchange Act.[7] Since there was nothing involuntary about Beneficial's determination, there is no merit to its position (Brief p. 10) that the involuntary nature of the short form merger excludes it from Rule 10b-5.

It was held in *Voege* v. *American Sumatra Tobacco Corporation,* 241 F. Supp. 369 (D. Del., 1965), that a short form merger under Delaware law involved a sale within the meaning of Section 10(b) of the Securities Exchange Act and Rule 10b-5 thereunder. "Any other view of the

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[5] As a result of the merger appellant had only the right to receive cash for his shares under the terms of the plan of merger or to seek to establish his rights as a dissenter in an appraisal proceeding under state law. We do not reach the question whether appellant would have had an adequate remedy in an appraisal proceeding. See *Borak* v. *J. I. Case Co., supra.,* 377 U.S. at 434.

[6] *See Voege* v. *American Sumatra Tobacco Corporation,* 241 F. Supp. 369, 373-74 (D. Del., 1965) and cases cited.

[7] Although this Court phrased its request for the Commission's participation in this appeal with respect to the question whether there was a "sale" of appellant's securities pursuant to the short form merger, the alleged fraud would appear to be in the "purchase" thereof, as these terms are generally used in the antifraud provisions of the securities laws. Thus, Section 17(a) of the Securities Act of 1933, 15 U.S.C. 77q(a), which covers fraud only in the "offer or sale" of securities relates to fraud only by the seller of securities, while Rule 10b-5 which includes fraud in connection with the "purchase" as well as the "sale" of securities includes fraud by the purchaser of securities.

transaction," the court noted, "would defeat the purpose of Rule 10b-5 . . ." *Id.* at 374.[8] This is in accord with one of the broad purposes of the Securities Exchange Act "to keep the channels of interstate commerce, the mail[s], and national security exchanges pure from fraudulent schemes, tricks, devices, and all forms of manipulation." *Hooper* v. *Mountain States Securities Corporation,* 282 F.2d 195, 202 (C.A. 5, 1960), *certiorari denied* 365 U.S. 814 (1961). This purpose would be thwarted if the investor protections afforded by Section 10(b) and Rule 10b-5 could be avoided by the formalistic view that there was no purchase of appellant's securities pursuant to the the merger of Crown into Beneficial's subsidiary. The Supreme Court has held that the securities laws must be construed "not technically and restrictively, but flexibly to effectuate . . . [their] remedial purposes." *Securities and Exchange Commission* v. *Capital Gains Research Bureau, Inc.,* 375 U.S. 180, 195 (1963). See also *Securities and Exchange Commission* v. *W. J. Howey Co.,* 328 U.S. 293, 301 (1946). And see *Errion* v. *Connell,* 236 F.2d 447 (C.A. 9, 1956), where the court said that the Securities Exchange Act created a federal remedy for one who has been defrauded of his securities.

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[8] Other cases likewise have held that transactions in mergers are purchases or sales of securities under Rule 10b-5. See *Simon* v. *New Haven Board & Carton Co.,* 250 F. Supp. 297 (D. Conn. 1966); *Securities and Exchange Commission* v. *Anaconda Lead & Silver Company,* (D. Col. No. 6819, July 11, 1961); *H. L. Green Company* v. *Childree,* 185 F. Supp. 95 (S.D.N.Y. 1960). But see, *Dasho* v. *The Susquehanna Corporation* (N.D. Ill. No. 65C1757, April 15, 1966, *rehearing denied,* June 28, 1966), *appeal pending*; See also *Blau* v. *Hodkinson,* 100 F. Supp. 361 (S.D.N.Y. 1951), where it was held that the acquisition by corporate insiders of stock pursuant to a plan of reorganization was a sufficient contract to acquire securities for purposes of recovering short swing profits under Section 16(b) of the Securities Exchange Act, 15 U.S.C. 78n(b). But see, *Roberts* v. *Eaton,* 212 F.2d 82 (C.A. 2, 1954), *certiorari denied,* 348 U.S. 827 (1954), where it was held that a reclassification of the outstanding stock of a corporation which could not lend itself to speculation encompassed by Section 16(b) was therefore not a "purchase."

The short form merger was only the last step in, and an integral part of, the allegedly fraudulent scheme to acquire the assets of Crown for less than their fair value. In this regard, the Supreme Court pointed out with respect to fraud in proxy solicitations that:

> "The injury which a stockholder suffers from corporate action pursuant to a deceptive proxy solicitation ordinarily flows from the damage done to the corporation, rather than from the damage inflicted directly upon the stockholder. The damage suffered results not from the deceit practiced on him alone but rather from the deceit practiced on the stockholders as a group." *Borak* v. *J. I. Case Co., supra.*, 377 U.S. at 432.

CONCLUSION

For the foregoing reasons the Commission urges that this Court hold that the amended complaint states a cause of action under Section 10(b) and Rule 10b-5 thereunder.

Respectfully submitted,

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Securities and Exchange Commission
Washington, D. C. 20549

November 1966.

Decision of District Court Filed February 23, 1966

#32090

Motion #50

1/25/66

[SAME TITLE]

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By LAWRENCE M. POWERS, ESQ.

For defendant Beneficial Finance Company, Inc.:

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New York, N. Y.
By WILKIE BUSHBY, ESQ.

OPINION

BONSAL, *D.J.*

Defendant Beneficial Finance Company, Inc. (Beneficial), a Delaware corporation, moves pursuant to Rule 12(b) of the Federal Rules of Civil Procedure to dismiss the complaint in this action for lack of jurisdiction and failure to state a claim on which relief can be granted.

Plaintiff, a resident of New York, record holder of 100 shares of Class A common stock of Crown Finance Company, Inc. (Crown), a Delaware corporation, instituted this action to recover damages on behalf of himself and the other Class A stockholders similarly situated, arising from an allegedly fraudulent scheme of merger under-

taken by the defendant Beneficial and the former directors of Crown. Plaintiff bases his claim on Section 10(b) of the Securities and Exchange Act of 1934 (15 U.S.C. §78j) and Rule 10b-5 promulgated thereunder by the Securities and Exchange Commission, and on the common law, and asserts jurisdiction under Section 27 of the Securities and Exchange Act of 1934 (15 U.S.C. §78aa) and on diversity of citizenship (28 U.S.C. §1332).

For the purposes of this motion to dismiss, the factual allegations of the complaint are accepted as true. *Arfons* v. *E. I. Du Pont de Nemours & Co.*, 261 F.2d 434 (2d Cir. 1958); *Cochran* v. *Channing Corp.*, 211 F.Supp. 239 (S.D. N.Y. 1962); 2 Moore, *Federal Practice*, ¶12.08, at 2244-45 (2d ed. 1964).

While the amended complaint (complaint) is diffuse and certainly not a model of short and concise pleading (Rule 8, Fed. R. Civ. P.), the following facts appear to be alleged:

Crown was a relatively small, publicly owned finance company. It had outstanding two classes of stock, Class A and Class B, with equal voting rights except that the holders of the Class B stock were entitled as a class to elect two-thirds of the members of the Board of Directors. Forty-six thousand, five hundred shares of Class B stock were outstanding, which were held by the directors of Crown, and 624,870 shares of Class A stock were outstanding in the hands of the public. It is alleged that the holders of the Class A stock were entitled to 80% of any dividends, and upon liquidation of Crown, would receive approximately 99% of the assets of the company.

The complaint alleges that in the spring of 1963 Beneficial decided to acquire Crown and to merge it into Beneficial's national network of personal loan offices. To achieve this end, it is alleged that Beneficial approached the directors of Crown, who were the holders of the Class B stock, and together they devised a fraudulent scheme to

defeat the rights of the holders of the Class A stock. The alleged fraudulent scheme involved three steps: (1) a purchase by Beneficial of the Class B stock from the directors of Crown; (2) a public offer or tender by Beneficial to the holders of the Class A stock to acquire 95% of the total outstanding shares of Crown; and (3) a short form merger of Crown into a wholly-owned New York subsidiary of Beneficial which would result in the acquisition of the remaining shares of Class A stock.

Acting pursuant to this allegedly fraudulent scheme, the complaint alleges that Beneficial purchased the Class B stock from the directors of Crown for $900,000. Thereafter, Beneficial offered to purchase Class A shares and purchased sufficient shares to give them 95% of the Class A stock for an outlay of $800,000. Thereafter, on September 30, 1965, Crown was merged into a wholly-owned subsidiary of Beneficial in New York under Section 905 of the New York Business Corporation Law (short form merger). The complaint alleges that the total of $1,700,000 paid to the Class B and Class A stockholders was at least $800,000 below the true worth of Crown as a going concern. The complaint further alleges that if Beneficial had acquired the assets of Crown, the Class B stock would have received less than 1% of the purchase price in a subsequent liquidation of Crown, whereas under the allegedly fraudulent scheme they received approximately 50%.

The complaint charges that in its public offer to purchase Class A stock, Beneficial made misleading statements as to the financial condition of Crown and omitted to state material facts as to the rights of the Class A stock in violation of the Securities and Exchange Act (Section 10(b) and Rule 10b-5). The complaint asserts a "spurious" class action on behalf of the plaintiff and all other Class A shareholders by reason of this alleged fraudulent scheme, based both upon the Securities and Exchange Act and the common law.

Defendant Beneficial contends that plaintiff does not come within the ambit of the Securities and Exchange Act, Section 10(b) and Rule 10b-5, since he did not accept Beneficial's offer for his Class A stock and he has not surrendered his stock certificates under the short form merger. Therefore, if a fraud was committed with respect to the plaintiff, it was not in connection with the purchase or sale of any security. Accordingly, argues Beneficial, the plaintiff was not a defrauded seller under Section 10(b). *Birnbaum* v. *Newport Steel Corp.*, 193 F.2d 461, 464 (2d Cir. 1952), *cert. denied*, 343 U.S. 956 (1952); *New Park Mining Co.* v. *Cranmer*, 225 F.Supp. 261, 266 (S.D.N.Y. 1963).

The courts have liberally construed the phrase "in connection with the purchase or sale of any security," *Cooper* v. *North Jersey Trust Co.*, 226 F.Supp. 972 (S.D.N.Y. 1964); *New Park Mining Co.* v. *Cranmer, supra; Pettit* v. *American Stock Exchange*, 217 F.Supp. 21 (S.D.N.Y. 1963); *Stockwell* v. *Reynolds & Co.*, S.D.N.Y., Sept. 22, 1965, CCH Fed. Sec. L. Rep. ¶91,579, but in each of these cases the plaintiff was a seller of securities and alleged that the fraud had induced the sale. Accepting the complaint as true, it would appear that the Class A stockholders who sold to Beneficial may have a cause of action against it, but this does not aid the plaintiff. As stated in *Kremer* v. *Selheimer*, 215 F.Supp. 549 (E.D.Pa. 1963): "It is not sufficient to show that a third person, in a separate transaction, was defrauded."

Plaintiff, however, relies on *Voege* v. *American Sumatra Tobacco Corp.*, 241 F.Supp. 369 (D.Del. 1965). In that case the court upheld a complaint as stating a cause of action under Section 10(b) of the Securities and Exchange Act which alleged the fraudulent acquisition of stock followed by a Delaware short form merger even though plaintiff did not sell his stock. But *Voege* involved Delaware law, while this action involves New

York law. Both Delaware and New York provide the method by which non-assenting stockholders may obtain an appraisal of their stock, but the New York law contains a saving clause not present in the Delaware statute. Section 623(k) of the New York Business Corporation Law provides that the appraisal proceeding "shall not exclude the right of such shareholder to bring or maintain an appropriate action to obtain relief on the ground that such corporate action will be or is unlawful or fraudulent as to him." Therefore, unlike the situation in *Voege*, the New York statute both provides for the plaintiff's right to a fair appraisal and preserves his right to challenge the legality of the merger. Under these circumstances, no reason here exists for attempting to extend the purview of Section 10(b) of the Securities and Exchange Act beyond the decisions of this circuit or in seeking to rationalize "in connection with the purchase or sale of any security" to the situation here presented.

For the foregoing reasons, the plaintiff has not stated a cause of action under the Securities and Exchange Act and therefore pendent jurisdiction cannot be applied to his common law cause of action. Nor does the court have diversity jurisdiction under 28 U.S.C. §1332 as to his common law action. While diversity of citizenship exists between the plaintiff and Beneficial, the only defendant served, the complaint does not satisfy the $10,000 federal jurisdictional requirement. The damage claimed for all 624,870 shares of Class A stock is $1,700,000 or approximately $2.73 per share. Plaintiff's proportion of this claim, as a record holder of 100 Class A shares, would be $273, far below the $10,000 requirement.

This result is not changed by the fact that plaintiff sues on behalf of all Class A stockholders. Although class actions may be maintained pursuant to Rule 23(a)(3) in actions of this type, *Oppenheimer* v. *F. J. Young & Co.*,

144 F.2d 387 (2d Cir. 1944), the representative of the class in such a "spurious" class action must individually allege the jurisdictional amount and cannot aggregate the claims of the class. *Central Mexico Light & Power Co.* v. *Munch*, 116 F.2d 85 (2d Cir. 1940); 3 Moore, *Federal Practice*, ¶23.13 (2d ed. 1964).

Nor can plaintiff satisfy the jurisdictional amount by casting his suit as a derivative action on behalf of Crown. In *Oklahoma Gas Co.* v. *Oklahoma*, 273 U.S. 257 (1927), it was held that the law of the state of incorporation governed the right of a dissolved corporation to sue or be sued. Crown was a Delaware corporation and Delaware law provides only for the continuance of actions pending by or against a corporation subsequently merged. 8 Del. C. §261; compare, N.Y. Business Corp. Law, §906. The present action was not commenced until October 13, 1965, whereas the merger took place on September 30, 1965. Under these circumstances, the Delaware courts have held that a derivative suit may not be maintained on behalf of the merged corporation. *Braasch* v. *Goldschmidt*, 199 A.2d 760, 767 (Ct. of Chan. of Del. 1964).

For the reasons stated above, the court lacks jurisdiction of this action, and the complaint fails to state a cause of action on which relief can be granted. Defendant's motion to dismiss is granted.

It is so ordered.

Dated: New York, N. Y.
February 23, 1966.

/s/ DUDLEY B. BONSAL
U. S. D. J.

U.S. DISTRICT COURT
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Feb 23 1966
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IN THE

Supreme Court of the United States

October Term, 1967

No. 348

BENEFICIAL FINANCE COMPANY, INC.,
Petitioner,

v.

LEO VINE,
Respondent.

REPLY BRIEF IN SUPPORT OF PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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PALMER & WOOD,
Of Counsel.

IN THE

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REPLY BRIEF IN SUPPORT OF PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

1. Novel and Important Questions Relating to Section 10(b) and Rule 10b-5 Are Involved.

Nothing in the respondent's opposing brief refutes our contention that there are involved in this case the novel and important "Questions Presented" set forth on page 2 in our petition.

What respondent does is to take the broad position that the federal securities statutes cover all cases of alleged fraud without regard to the limitations of the statutory provisions—particularly the limitations appearing in Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated thereunder. That statute and rule prohibit fraud only in connection with the purchase or sale of a security and this must mean that they apply only if there are (a) a sale or purchase of a security and (b) fraud

in connection with such sale or purchase. Neither ingredient is present here where respondent claims to be a seller although he has never in fact sold his stock (or done anything else except bring this suit) and where there was admittedly no sale or purchase of a security by the corporation he claims to represent derivatively.

This is the first case in which it has been held under Section 10(b) and Rule 10b-5 that a minority stockholder who, under the applicable state statutes covering short form mergers has not been called upon to take any action to make the merger effective, nevertheless has, by reason of such short form merger, not only made a "sale" of the stock certificate he still holds but that there also has been fraud "in connection with" such supposed sale of such certificate although no representations whatever were made to him.

Respondent endeavors to make it appear that the holding of the Court of Appeals below (reversing the District Court) is well settled and narrow. However, that the decision is novel is shown by the Court of Appeals opinion itself which states (Petitioner's Appendix, pp. A-11 and A-12) (a) that in the one case involving somewhat similar facts (*Voege* v. *American Sumatra Tobacco Corp.*, 241 F. Supp. 369 (D. Del. 1965)), the District Court decided the case on a different theory from that evolved below* and (b) that there also was no other case squarely in point.

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* Respondent also asserts in his brief (pp. 16-18) that the Court of Appeals did not follow the different theory which the Securities and Exchange Commission supported in its *amicus curiae* brief. It should be pointed out that the Commission has never made any formal ruling or interpretation extending Rule 10b-5 to mergers of any sort and that the *amicus* brief is simply authored and signed by lawyers for the Commission and not by the Commission or any member. In this connection, it should also be pointed out that a more eminent counsel for the Commission filed a brief on its behalf taking the contrary position that a merger was not a sale (Petition, p. 8 fn.).

In this situation, the Court below, in order to sustain its ruling, invented the theory that effectuation of the short form merger made the respondent, who had in fact done nothing, a "forced seller" of his stock to the surviving corporation. We submit that this was judicial legislation because respondent was not a seller at all.

In fact, respondent and the Court of Appeals both advert to a phrase in the Securities and Exchange Act of 1934 out of context. This is the definition contained in Section 3(a)(14) of "sale" and "sell." They call attention to the phrase "otherwise dispose of" as if it referred to a disposition of some type other than by way of voluntary contract. But this is not so. It is clear that the definition refers only to a "contract to sell or otherwise dispose of," thus requiring volition in order for a transaction to come within the definition. There was certainly no volition on the part of the respondent. He did nothing in connection with petitioner's tender offers or the merger.

The respondent (pp. 9-10) cites and quotes from *J. I. Case Co.* v. *Borak*, 377 U. S. 426, 432 (1964), which refers to deceit practiced on stockholders as a group. That case is inapposite because the decision involved only the proxy rules promulgated under Section 14 of the Act which are not limited by their terms to purchase or sale of securities and fraud in connection with such purchase or sale. When this Court, in the above case, referred to deceit practiced on "stockholders as a group", it was sustaining the right of a stockholder to bring a derivative action on the ground that a deceptive proxy solicitation would lead to damage to the corporation and affect the stockholder only indi-

rectly.* The statutory provision and the issue involved in that case are entirely different from those involved in the present case.

Similarly, the citation by respondent (pp. 11-12) of *Dasho* v. *Susquehanna Corp.*, 380 F. 2d 262 (7th Cir. 1967) is inapposite because, like *J. I. Case Co.* v. *Borak, supra,* it involved a conventional merger in which stockholders were solicited to vote on the basis of alleged misrepresentations and omissions. Thus, the difference between that case and the present case is not, as claimed by respondent (p. 12), only that shares were exchanged for other shares instead of for cash. In the *Dasho* case, the plaintiffs were suing derivatively in the right of the corporation which was alleged to have been defrauded in acquiring securities and issuing its own securities, a clear Rule 10b-5 case. On the contrary, the derivative action attempted to be alleged by the plaintiff in the present case was dismissed by the District Court, and the dismissal was affirmed by the Court of Appeals (Petitioner's Appendix, p. A-18).

Several times in his brief (*e.g.*, pp. 5, 9), the respondent states that, following the short form merger, he was left

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* Respondent (p. 10) has sought to support his contentions by an inaccurate quotation from the *Borak* case. He has omitted from his quotation parts of the opinion which are needed in order to show what this Court did hold. The italicized words in the following quotation from the *Borak* opinion (377 U. S. at p. 432) shows the material which the respondent omits:

> "The damage suffered results not from the deceit practiced on him alone but rather from the deceit practiced on the stockholders as a group. *To hold that derivative actions are not within the sweep of the section would therefore be tantamount to a denial of private relief.* Private enforcement of the *proxy* rules provides a necessary supplement to Commission action. As in antitrust treble damage litigation, the possibility of civil damages or injunctive relief serves as a most effective weapon in the enforcement of the proxy requirements."

only with a claim for $3.29 per share. As the Court of Appeals pointed out (Petitioner's Appendix, p. A-10), the $3.29 figure represented an offer by the petitioner corporation and respondent also had a right of appraisal. This would have produced for him the full value of his shares if, as he alleges, that was greater than $3.29 per share, so that his rights were fully safeguarded.

2. Reckless Statements in Respondent's Brief Should Be Ignored.

Apparently in an attempt to strengthen the claimed "equity" of respondent's case, his counsel has indulged in reckless and unjustified statements in his brief regarding the allegations of the amended complaint and the determinations of the Courts below. These statements should be ignored.

There are no allegations in the amended complaint that age motivated Crown's officers in selling out (*cf.* Resp. Br., p. 4)*, or that the two companies had interlocking directorates at the time of the offers (*cf.* Resp. Br., p. 4) and there could be no such allegation, or that Beneficial did not set forth in its printed offer its arrangements to purchase the controlling Class B stock of Crown (*cf.* Resp. Br., p. 5) and there could be no such allegation, or that petitioner was aided by the Class B stockholders in obtaining acceptances of its offer by the holders of the Class A stock (*cf.* Resp. Br., pp. 5-6) and there could be no such allegation.

* On page 4 of his brief and footnote 1 thereto, the respondent refers to what he calls "key facts" stated to be taken from his proposed Second Amended Complaint in which respondent reverses his field and claims to be a defrauded purchaser instead of a seller, which pleading he was denied leave to file by the District Court, the denial being affirmed by the Court of Appeals (Petitioner's Appendix, pp. A-16 and A-17). It appears to us improper for respondent to rely in this Court on alleged facts appearing only in the pleading he was refused permission to file.

The District Court did not "concede" that petitioner's tender offer gave rise to a securities fraud cause of action by holders of Class A stock of Crown who accepted the offer, and the Securities and Exchange Commission brief did not characterize the offer as a clear violation of Rule 10b-5 (*cf.* Resp. Br., p. 5), but in each case said in effect only that the allegations of the amended complaint, if true, might constitute a cause of action.

3. The Decision Below Leads to Incongruous Procedural Results.

The *amicus curiae* brief filed by the Securities and Exchange Commission below demonstrates the impracticable procedure which would result in this and similar cases if the decision below were allowed to stand. The decision is that, while respondent did nothing and was not defrauded into making a sale, alleged misrepresentations were made to numerous other Class A stockholders who thereupon sold their stock and this brought respondent within the purview of Rule 10b-5 as if he were himself a defrauded seller. In this connection, in the *amicus curiae* Commission brief below (which is annexed to respondent's brief here) it is stated by the Commission that appellant [respondent here] could not recover if it should be found that those who did sell would have done so irrespective of any alleged misrepresentation or omission. The Commission said (Respondent's Appendix p. 37, footnote 3):

> "Of course, appellant's action here would fall if it should be found that those who sold pursuant to the tender offers would have done so despite the allegedly misleading representations or omissions."

It is extraordinary to contemplate that, under the decision of the Court below, in order to ascertain whether respondent has a Rule 10b-5 cause of action, it would be

relevant and necessary to explore the minds of over 2,000 Class A stockholders who did sell their stock years ago, but who have made no claim herein, in order to determine whether they relied on the alleged misrepresentations or omissions.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

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